A CONTRIBUTION TO THE STUDY OF CORPORATE GOVERNANCE IN THE CONTEXT OF THE GREEK LEGAL ORDER

By

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All errors and omissions that this work may have are solely mine, for which I take full responsibility.

DECLARATION

I, Kyriaki Mavrommati, declare that this thesis, submitted in fulfilment of the requirements for the degree of Doctor of Philosophy in Law, University of Warwick, is wholly my own work unless otherwise referenced or acknowledged. The document has not been submitted for qualification at any other academic institution.

A certain amount of material in this thesis was included in articles written and published during my doctoral candidacy. More particularly, the analysis on gatekeepers, corporate culture, and whistleblowers included in Chapter 1, Section 4 ('Understanding the gatekeeping rationale upon which gatekeepers' role materialises', 'The failing corporate culture amid the absence of effective whistleblowers' protection mechanism', and 'Understanding the importance of establishing effective whistleblowing mechanisms'), which grew out of this thesis, was published as 'The Dynamics of Gatekeepers, Corporate Culture and Whistleblowers' (2005) 1 (3) The Corporate Governance Law Review 383.

Some of the materials used are only available in Greek and bear the indication *'in Greek'*. Unless otherwise indicated, all translations of Greek material are my own. Quotations from interviews, newspapers, etc., were translated as literally as possible, except in the case of some institutional names for which English language equivalent exists. Modern Greek spelling is used in the body of the text.

To Manolis,

My Beloved Husband

ABSTRACT

This thesis examines the corporate governance affairs within the specific framework of the Greek market. Corporate governance has become a major topic of debate and policy development in the world of business, policy makers, and academics around the globe. The increased attention to corporate governance is due to its legal, economic, and institutional significance to the effective functioning of markets and corporations operating thereof. Likewise in Greece, although the corporate governance discussion is at an infant stage, yet there are some reasonable signs showing that the issue escalates on the agenda of boardrooms and policy makers. Notwithstanding that the thesis is informed by the principal agent theory, a more contextualised approach to it is adopted. This is so for confirming a key proposition of the thesis in that the diversity of corporate arrangements, specific corporate governance patterns, and approaches are mediated by their fit or alignment with situational variables arising in diverse organisational, corporate, and legal environments. By applying this contextualised approach, the Greek corporate governance attributes are identified, showing that although the Greek system has been influenced by other paradigms, yet situational variables and adaptations to domestic attributes make it a distinct, hybrid rules based system. Using statistics from two corporate governance surveys that measure the level of corporate governance of Greek corporations, a discrepancy between the objectives of the corporate governance standards, compliance, and actual governance efficiency is established. In explaining such discrepancy, this thesis goes further on providing in-depth reasoning upon the specific situational variables of the Greek corporations and the market as a whole. It is admitted that the tendency of the Greek regulator to legislate on corporate governance matters rather the issuing principles, has created an overly bureaucratic, rigid, and inflexible legal framework. In addition, problems with implementation and enforcement of corporate governance requirements have been identified and their prevalence is explained by country-specific attributes. The overarching objective of this thesis is that the identification of those situational variables - that to some certain extent restrain the fulfilment of the corporate governance objectives- becomes a useful tool for policy makers and corporations' themselves in generating realistic and effective measures that need be taken if governance efficiency is to be strengthened. The establishment of a strong, efficient, honest governance system shall be an ongoing priority for both firms and the Greek market. Moving towards governance efficiency from the deeply rooted, country specific deficiencies of Greek corporations and the market, will inevitably be a long run, perhaps never ending process, in which both the substance and the sequencing of policies will be important.

LIST OF ABBREVIATIONS

ADECH	Athens Derivatives Exchange Clearing House
ADEX	Athens Derivatives Exchanges
AG	Allgemeine Gesellschaft
AGII	Association of Greek Institutional Investors
AK	Hellenic Civil Code *(in Greek)*
ASE	Athens Stock Exchange
ASYK	Capital Market Development of System and Support *(in Greek)*
ATHEX	Athens Exchange
BCBS	Basel Committee on Banking Supervision
BoG	Bank of Greece
CEO	Chief Executive Officer
CCG	Committee on Corporate Governance
DTI	Department of Trade and Industry
EAGAK	Greek Market for Emerging Capital Markets *(in Greek)*
ELKE	Hellenic Centre for Investment *(in Greek)*
EMU	Economic and Monetary Union
ESRI	Economic and Social Research Institute
ETVA	Hellenic Bank for Industrial Development *(in Greek)*
EU	European Union
FATF	Financial Action Task Force
FBI	Federation of Business and Industries
FDI	Foreign Direct Investment
FGI	Federation of Greek Industries
FRC	Financial Reporting Council
FSA	Financial Supervisory Authority (UK)
GSEE	General Union of Employees in Greece *(in Greek)*
HBA	Hellenic Bank Association
HCMC	Hellenic Capital Market Commission
HIIA	Hellenic Institute of Internal Auditors
IAS	International Accounting Standards
IASB	International Accounting Standards Board
ICAEW	Institute of Chartered Accountants in England and Wales
ICGN	International Corporate Governance Network
IFRS	International Financial Reporting Standards
IIA	Institute of Internal Auditors
IMF	International Monetary Fund
INE	Institute of Employment *(in Greek)*

IOSCO	International Organisation of Securities Commission
IPO's	Initial Public Offerings
ISD	Investment Services Directive
LSE	London Stock Exchange
NEHA	New Stock Exchange Markets *(in Greek)*
NYSE	New York Stock Exchange
OECD	Organisation for Economic Cooperation and Development
PCAOB	Public Company Accounting Oversight Board
SE	Societas Europea
SEC	Securities Exchange Commission

INTRODUCTION

Corporate governance is mainly concerned with those mechanisms and methods aiming to align the interests of managers (agents) with those of investors (principals). In this thesis, corporate governance is approached from the angle of its dual purpose, namely ensuring business development and protecting shareholders' rights. This study recognizes the increasing significance of legal foundations and the necessity for an effective corporate governance system.

The thesis examines the Greek corporate governance framework and it claims that while a considerable amount of corporate governance rules exist, the achievement of its main objectives can be circumscribed not only by the tendency of the Greek regulators to legislate corporate governance rules, as opposed to voluntary Codes of Conduct and recommendations, but mainly by the moderate level of compliance with those rules, and the generally weak enforcement environment, as two strongly interrelated conditions.

This claim is explored by examining three related issues. The first is the set of corporate governance rules that describes the Greek regulatory framework. A brief review of the evolution of corporate governance rules in the Greek market is undertaken, so as to reveal the alleged tendency of the Greek regulator to legislate corporate governance rules as opposed to developing best practices and/or recommendations. The second is the moderate level of compliance of Greek corporations with the corporate governance rules and recommendations, as recorded by the two recent Grant Thornton Corporate Governance Surveys conducted in 2005 and 2006, respectively. Finally, the third issue does not relate to the presence of the corporate governance laws but rather to the actions taken against violations of those rules. Such legal actions determine not only the overall strength of the enforcement environment but also the extent to which corporate governance rules are enforceable.

The argument presented is three-fold. First, that in the rather brief historic context, the binding effect of corporate governance rules in Greece was determined by the Greek regulator contrary to the intentions of interested groups and unions that had issued their own corporate governance principles and not binding ones. Such tendency on its own is not a problem, only to the extent that an overly bureaucratic framework is created, where rigid and inflexible rules dominate, restricting companies from effectively adapting to rules.

Second, that the findings of the recent Grant Thornton Corporate Governance Surveys record moderate levels of compliance not only with the non-binding recommendations but also with the binding rules. The latter, particularly, is interesting to the extent that not only rejects our initial expectation that binding rules would be coupled with reasonably good levels of compliance, but also confirms that the specific corporate structures of Greek corporations have set corporate governance obligations as exogenous ones.

Third, that the abovementioned moderate compliance of Greek corporations with the binding corporate governance rules is reckoned to be preserved, to a certain extent, on account of weak enforcement actions. More particularly, this is demonstrated by measuring the total number of non-compliant corporations with the total number of fines imposed. Although there are considerable limitations to data, an initial examination shows that there is a discrepancy between the total number of non-compliant companies and the fines imposed against those non-compliant behaviours. Such discrepancy implies an enforcement gap and lack of enforcement actions. Both implications support the main claim of this study that the objectives of corporate governance are not fully met, thereby the real benefits and positive effects from the existence of a good corporate governance framework seem not to be reaped. Following the above, as a conclusion, this study makes a case for increasing the focus of corporations themselves, the policy makers, and Greek regulators on finding ways to sharpen their understanding of corporate governance and enhancing governance efficiency.

The methodology of the study is informed by the principal-agent theory, as expressed first by Berle and Means, reiterated by Coase; Jensen and Meckling; Fama and Jensen; Aghion and Bolton; and further clearly articulated by Hart. No attempt is made here to replicate the wide-ranging theoretical accounts of corporate governance written by the aforementioned distinguished scholars. Rather the study builds on the main elements of the theory provided by these scholars and develops arguments in favour of a more contextualised approach to explaining the key assumptions of this theory. Such an approach is unveiled around the proposition that the diversity of corporate arrangements and specific corporate governance patterns and approaches are mediated by their fit or alignment with situational variables arising in diverse organisational, corporate, and legal environments.

In general terms, the significance of such approach is that it explains the specific corporate governance arrangements that are context-dependent. It follows that the variations of those arrangements make clear why corporate governance systems differ so much across countries. In its narrowest perspective, the benefits of such contextual view of the principal-agent theory are to better capture and understand the Greek corporate governance arrangements. More particularly, it is shown that the corporate attributes of the Greek landscape, (e.g. civil law regime with family dominance in corporations), give rise to certain agency problems, not necessarily the same as those of other jurisdictions with different attributes, such as diffuse ownership and common law regimes, e.g. the Anglo-Saxon. In addition, building on that discussion, it is explained why specific disciplining mechanisms, such as fiduciary duties and executive compensation schemes, while key tools to alleviate agency problems in other jurisdictions, in the specific context of Greek corporations are not so widely used.

For this purpose, and besides the focus of this thesis on the corporate governance state of affairs in the specific context of the Greek market, a brief reference to other jurisdictions (such as the USA, UK, Germany and Japan) is also made. This is important, first, because in the context of the increasing activism in the sphere of corporate governance around the globe, strong influence from the corporate governance practices of other countries and legal regimes can be observed. Additionally, such comparative analysis contributes to stressing that corporate governance research and discussion should progress to a more context-dependent understanding of corporate governance patterns. This will prove very useful for practitioners and policy makers interested in applying corporate governance in particular situations and regimes. Further, Greece can learn from other jurisdictions, in an effort to fulfil the objectives of its corporate governance system.

The case of Greece is examined as a small stock market that operates among developed capital markets within Europe and more particularly within the area of Balkans, where Greece has a strong economic role to play.

Additionally, Greece is a member of the Organisation for Economic Cooperation and Development (OECD) since 1960, a member of the European Union (EU) since 1981 and a member of the European Monetary Union (EMU) since 2001. Those memberships not only place Greece among other developed countries but also demand for continuous efforts to sustain its development and competitiveness. The Greek corporate governance system emerged following a worldwide expansion in corporate governance activism, while in contrast with other jurisdictions the tendency of Greek regulators to legislate corporate governance issues is characteristic. Moreover, as demonstrated above, the moderate level of compliance with the corporate governance rules, mainly as a result of the generally weak enforcement environment, but also of a typical non-compliant corporate attitude of the Greek corporations, provide unique information.

This thesis is a full-length study that discusses the relationship between Greek corporate governance rules and the extent to which those are implemented, as documented by recent Corporate Governance Surveys. Most importantly, it mainly attempts, for the first time, to explain such relationship on accounts of country-specific attributes that can restrain the achievement of the objectives and aims of the Greek corporate governance framework. Further, upon those country-specific variables, this is the first thesis that seeks to help to identify a series of priority actions required to execute effective corporate governance strategies. The study concludes by suggesting paths and ways that need be taken in order to overcome those country-specific elements that circumscribe the achievement of corporate governance objectives.

Chapters one and two provide the theoretical base on which the later discussion of Greek corporate governance is built. *Chapter One* reviews the literature on those reasons that illuminate the importance of good corporate governance and provide the basis for explaining why corporations are better off with the application of good corporate governance. Those reasons are explained by applying two different techniques of analysis. First, by focusing on the positive correlations of good corporate governance (positive analysis). That is to depict the benefits that can be recorded from the application of good corporate governance practices, as those are illustrated by numerous academic studies, some of which use empirical data to explain those positive correlations. Second, by focusing on the negative implications from the absence of good corporate governance structures (negative analysis). That is by briefly discussing the most recent corporate scandals in USA and Europe (e.g. Italy) that highlighted with the most prominent way how considerable weaknesses in corporate governance structures can have adverse effects both in business development and the protection of shareholders' rights.

This chapter suggests that good corporate governance is a key element in ensuring business development and protecting shareholders rights, and it argues that good corporate governance is likewise crucial for Greek corporations (family firms in their majority) even though the latter do not heavily rely on external financing. More particularly, the above analysis, apart from contributing to the global corporate governance debate, serves the purposes of the present thesis for two main reasons. First, the negative analysis is significant because, for the first time in the literature on Greek corporate governance, an attempt is made to shed some light on the lessons that Greece can learn from those corporate scandals. Second, the positive analysis is important because it aims to provide a synthesis of those reasons that explain the importance of good governance. Such synthesis could be a useful tool for the Greek corporations and public authorities, both for serving as a comprehensive, basic resource to consult in the context of future governance reforms, and as a means to place governance arrangements high up in the reform agenda.

Chapter Two establishes the main theoretical context in which the corporate governance concepts evolved. It begins by developing arguments in favour of a more contextualised approach to the principal agent theory, on the key assumptions of which most corporate governance issues are described. Such an approach develops around the proposition that the diversity of corporate arrangements (mainly relating to the ownership and control of firms), specific corporate governance patterns (such as the financing of firms), and approaches (e.g. policy responses and disciplining mechanisms) are mediated by their fit or alignment with situational variables arising in diverse organisational, corporate, and legal environments. The significance of such approach is that it explains the reasons why corporate governance systems differ so much across countries.

Chapters Three and Four return to examining the central proposition at the study's core in that while a considerable amount of corporate governance rules exist in Greece, their main objectives can be circumscribed not only by the tendency of the Greek regulators to legislate corporate governance rules as opposed to relying on voluntary codes or recommendations, but mainly by the moderate level of compliance in practice with those rules, and the generally weak enforcement environment.

More particularly, *Chapter Three* explores the first branch of this proposition in that the current Greek corporate governance system, which entails a large amount of rules, contains rules that overlap with other legislation. Such overlaps and the inherently rigid civil law system are reckoned to create an overly bureaucratic legal framework, which in turn restricts the achievement of the corporate governance objectives.

To confirm such proposition, this chapter, first, describes the Greek corporate governance attributes applying the contextualised approach, as established in chapter two. It seeks to explain the specific patterns of the Greek corporate governance arrangements and to highlight that due to situational variables the Greek corporate governance system, though it follows closely the models of other jurisdictions, major adaptations to domestic attributes make it a distinct, 'hybrid rule-based' system.

It then tries to further understand those legal and economic assumptions that explain the shape of the existing corporate governance framework. To that end, it reviews the structure of the Greek capital and securities market in that the Greek capital market law and securities legislation has provided the legal background for defining numerous corporate governance principles, especially the introduction of the Corporate Governance Law in 2002, which applies to all listed companies.

Furthermore, it presents the evolution of the corporate governance rules in an attempt to place the corporate governance activism in the Greek market after the year 1999, when the slowdown of the Athens Stock Exchange (ASE) revealed a number of irregularities that demanded prompt corrective actions. The study then goes through the main provisions of the Corporate Governance Law of 2002, focusing on its interpretational ambiguities, its drafting generalities, and the unnecessary burden that it creates to listed firms. The objective is to establish the regulatory overlaps, the tendency of the regulator to legislate on corporate governance matters (hard law approach), and the existence of a poorly drafted law. On those accounts it can be explained that the specific content of those provisions, alongside the implementation method through hard law, significantly determine the level of efficiency of the Greek corporate governance system.

In further attesting the tendency of the Greek regulator to legislate and confirming the nature of the Greek rules-based corporate governance system, a review is undertaken on the legislative means by which the EU capital market law and the OECD Corporate Governance Principles are introduced in the Greek legal order. Such analysis serves to explain two facts. First, that these two sources of law are significant for determining the Greek corporate governance universe, given that, particularly with respect to the EU legal principles, the Greek regulator tends to closely follow the developments in the EU legislation. Second, that these two sources of law possess a prominent position in the Greek legal order since they are binding legal principles usually introduced by the enactment of legislation.

Finally, the analysis of this chapter is important to the extent that it provides the building block for the analysis that follows in chapter four, in an attempt to show that the current, and rather rich (in terms of volumes of legal documents), legal framework governing the corporate governance practices of Greek corporations (mainly listed firms) is overly bureaucratic and rigid. In turn, obstacles are created in achieving satisfactory levels of compliance, dramatically undermining corporate governance system's efficiency.

Building on the arguments of chapter three, the objective of *Chapter Four* is to discuss the recorded discrepancy between the objectives of the corporate governance standards, compliance, and governance efficiency. For this purpose, the analysis takes place on two main dimensions. First, the study of the level of compliance of Greek listed companies with the corporate governance standards, as documented by recent Corporate Governance Surveys. Second, upon discovery of an overall moderate level of compliance of Greek listed firms with the corporate governance requirements, the focus of the analysis shifts to further explore those country specific factors that have mainly contributed to such discrepancy.

The analysis of chapter four goes beyond merely reviewing the contradiction, where Greece is a country, which besides the existence of a wide range of corporate governance obligations, its overall governance is not as efficient as the aims of the corporate governance rules, and best practice recommendations have designed it to be. It goes further by providing in-depth reasoning to explain this contradiction, which seems to be strongly associated with another paradox in that the Greek corporations fail to comply not only with the binding corporate governance requirements, but also with the non binding.

Against this backdrop, chapter four attempts to shed some light on the overall performance and efficiency of the Greek corporate governance system based primarily on two recent Corporate Governance Surveys that examine the corporate governance compliance. The fundamental contribution of this analysis is twofold. First, it is a full-length analysis that discusses the relationship between Greek corporate governance rules and the extent to which those are implemented, as documented by recent Corporate Governance Surveys, but mainly attempting, for the first time, to explain such relationship on accounts of country-specific attributes. Second, by examining those factors that can circumscribe the achievement of the objectives and aims of the Greek corporate governance framework, it facilitates the design of realistic and effective suggestions for improvement, in an attempt to mitigate the specific corporate governance weaknesses in the Greek corporate structures.

Finally, *Chapter Five* discusses a wide range of proposals that could help overcome those country-specific obstacles in fulfilling the objectives of corporate governance and achieving greater efficiency. The key claim of this chapter is that the establishment of a strong, efficient, honest governance system is an ongoing priority both for firms and the Greek market, as a whole. It is admitted that the Greek corporate governance need be further improved through a number of mechanisms (internal to the firm and external).

More particularly, given that a key precondition for ensuring greater firm transparency and accountability is firms' awareness of the importance of introducing and applying good corporate governance practices, the first recommendation covers mainly those steps in raising such awareness (such as the increased participation in international fora discussing corporate governance matters, the wider use and development of governance rating systems, and fostering corporate governance education). Furthermore, the role of internal auditors and the audit committee in improving the governance process are also discussed as important mechanisms to increase management's accountability and ensure transparent procedures.

Moreover, a corporation receives a number of exogenous pressures to introduce and apply good corporate governance practices within the firm. In this vein, recommendations are advanced on five dimensions. First, from a supervisory point of view the focus relies on strengthening the supervisory and monitoring capacity of the Hellenic Capital Market Commission (HCMC), as the competent body that is empowered to monitor and check compliance with corporate governance rules. Second, from a legal review perspective, codification and review of existing corporate governance rules is discussed in an attempt to eliminate the overly bureaucratic legal framework, obscurity, and inefficiency of those rules. Third, from a regulatory point of view, the increasing involvement of the ASE in the corporate governance regulatory process (listing requirements) is discussed. Fourth, from an enforcement perspective, the discussion focuses on the possible reforms mainly for the improvement of the judicial system so that enforcement and implementation of rules is enhanced. Fifth, from the shareholders' view a discussion takes place on those measures that could ensure enhanced protection of shareholders' rights and increased activism.

In addition, within the framework to promote the positive efficiencies of good governance and enhance governance efficiency, the following recommendations are also discussed as a means to further advance the potentials of the Greek corporate governance. First is the encouragement of the more active participation of business associations and unions. Second is the establishment of a Corporate Governance Association of Greece. Third is the consideration of establishing a shareholders' association. Fourth, it is recommended that an Institute of Directors be established.

Overall, the above recommendations are intended to achieve a balance among company managers' need for flexibility to meet rapidly changing business conditions, companies' need for increasing their market value, investors' need to monitor what managers do with their money, and shareholders' need for protection. The range of recommendations discussed, although adapted to the specific background of Greece's current conditions, go beyond help mitigating country-specific obstacles. This is so because it is our intention to stress that shifting from governance weaknesses to governance efficiency, demands well-designed measures and appropriate actions to be taken within the framework of a comprehensive strategy for the reform of the corporate governance system, while a-la-carte solutions are finite and not viable. The success of such strategy demands political consensus and strong commitment of policy makers, the business world, and the society at large, to change deeply rooted decision making structures and societal balances favourable to a mere notional implementation of corporate governance rules.

PART ONE

THEORETICAL FOUNDATIONS: REVIEWING THE CORPORATE GOVERNANCE LITERATURE

CHAPTER 1

IMPORTANCE OF CORPORATE GOVERNANCE: EXPLAINING WHY CORPORATIONS ARE BETTER OFF WITH GOOD GOVERNANCE

1. INTRODUCTORY REMARKS

The Purposes and the Structure of this Chapter

This first chapter seeks to provide an overview of those reasons that explain why good corporate governance makes sense, with an eye on those elements and indications that reflect its increasing importance and provide clear sight of the reasons that it matters both for business and economic development and the protection of shareholders' rights. It intends to add a core layer to the literature review and the discussion of the theoretical. background of corporate governance and how to measure its legal and institutional significance. One main question is, therefore, addressed: why care about good corporate governance?

For the purposes of the present study, good corporate governance describes a system that assures that all those necessary checks and balances are in place, in an effort to achieve business development and protect shareholders' rights. Key aspects of such system of checks and balances are considered to be first, the existence of well-functioning laws, regulations, and business practices to govern and promote the corporate affairs, and second the proper implementation and compliance of such rules. More particularly, in this study, the effects of good corporate governance arrangements are documented on a general framework and are not distinguished by the impact that each different corporate governance model, for instance insider versus outsider model, has on the corporate market and the economy.[1]

In an attempt to explain why corporations are better off with the application of good corporate governance, two different techniques of analysis are employed, the positive and the negative analysis.[2] The *positive analysis* focuses mainly on describing the positive correlations of strong corporate governance to business development and the protection of shareholders' rights. Although, in this study the corporate governance concept is approached from the angle of its dual purpose, namely ensuring business development and protecting shareholders' rights, for the sake of completion a brief reference to positive efficiencies on other parameters, such as growth and economic efficiency, is also made. The contribution of such analysis is that it can serve as a comprehensive synthesis of all those efficiencies that explain the heated debate around corporate governance and can urge Greek corporations to put this issue high up in their corporate agenda.

In turn, the *negative analysis* discusses the implications of weak corporate governance structures using as case studies the negative effects of the most recent corporate scandals occurred in the US and Europe (e.g. Italy). The findings of the negative analysis show that it is proven to be difficult for a corporation to remain afloat and profitable if there are no, *inter alia*, concrete corporate governance arrangements in place. This is particularly illustrated by

[1] Such analysis has been conducted by Shleifer, A., and R. W. Vishny, 'A Survey on Corporate Governance' (1997) 52 (2) J Fin 737, who examine separately the impact of different corporate governance systems and document which of the models is most profitable and efficient for the economy.
[2] The naming and inception of those techniques is solely of the author and are employed for ease of convenience when describing the positive and negative correlations with regard to corporate governance.

the examination of the failure of the Parmalat in Italy. Therefore, the additional importance of the negative analysis rests on the fact that it serves as a useful reference point, aiming to underline those indications that drive or will be able to drive governments, regulators, and policy makers, e.g. in Greece, to respond to demands for stronger corporate governance. Greece can learn significant lessons from those scandals in the US and Europe, respectively.

Having thus far established the increased significance of strong corporate governance, both by using the positive and the negative analysis, for ensuring business development and protecting shareholders' rights, it is argued that likewise in the more specific context of Greece and in the case of family controlled firms strong corporate governance arrangements are equally beneficial. One could well argue that Greek corporations, as mainly family business that do not heavily rely on external finance, arguably the most decisive condition for the existence of corporate governance, would not be much interested in strong corporate governance. However, this is not the case. As is analysed, strong corporate governance structures in the case of family firms include at their core the agreement of solid succession plans, in the sense that family firms are interested in continuing their profitable operations for many more generations. Hence, the concept of the corporate governance is introduced and considered as important for family firms as well.

Building on the above review of corporate scandals in the USA and Europe (e.g. Italy), this chapter then concludes with a brief analysis of three interrelated conditions that seemed to have adversely undermined, *inter alia*, the soundness of the corporate governance frameworks in the respective jurisdictions. These conditions have been identified to be, first, the establishment of a corporate culture that is not corporate governance centred and therefore does not ensure proper corporate behaviours and actions; second, the failing role of gatekeepers; and third, the weak whistle-blowing mechanisms. The aim of this analysis is to highlight a number of conditions that were only recently understood as decisive corporate governance parameters.

Recognising that these conditions can devalue and dramatically hinder the achievement of the dual scope of corporate governance (business development and the protection of shareholders' rights), the research focus shifts to examine the state of these conditions in the specific context of the Greek market and the Greek corporations operating thereof. The aim of this analysis is twofold. One, it is to show that although the above three conditions are not strictly speaking country specific factors (in relation to Greece), as the ones extensively discussed at the core of this thesis, they can nevertheless dramatically circumscribe the objectives of the Greek corporate governance system. Two, it is to demonstrate that there are important lessons for Greece to learn from those failures and that it is crucial that fundamental provisions are devised so as to address those weaknesses in an effort to secure the Greek corporate market and avert similar corporate failures.

The Controversial Dimensions of the Corporate Governance Discussion

Whereas a number of distinguished scholars have dealt with various issues falling in the broad sphere of corporate governance, such research entails three main controversial points. First, is the lack of consensus on the definition of corporate governance. The rapid adoption of the term 'corporate governance' has not been accompanied by a consistent and uniform usage. Different authors vary widely in where they draw the boundaries of the subject. In its narrowest sense, the term may describe the formal system of accountability of senior management to the shareholders. At its most expansive, the term is stretched to include the entire network of formal and informal relations involving the corporate sector and their consequences for society in general.[3]

For the purposes of the study, a general corporate governance definition is adopted in the sense that it includes all those mechanisms (internal and external) through which firms are operating when ownership is separated from management and the nexus of obligations, rights and controls, aiming to protect the interests of shareholders (as the financiers) and other stakeholders. Ultimately, corporate governance mechanisms aim to deal with the ways and the complex set of constraints with which suppliers of finance to corporations (i.e. shareholders) assure themselves of getting a return on their investment, *vis-à-vis* money, and capital stock, by minimizing managerial opportunistic behaviours.[4]

Second, it is the broad nature of the subject of corporate governance that represents another problematic dimension of the term. In practice, corporate governance arrangements do not form a separate legal category but

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[3] *See, e.g.,* Keasey, K., S. Thompson, and M. Wright *Corporate Governance, Economic, Management and Financial Issues* (OUP, Oxford 1997). The decisive elements of the term corporate governance are defined also by the nature of the firm's activities. More specifically, in the context of the unique operation of financial institutions, the impetus of corporate governance laws and mechanisms is somehow broadened so as to explicitly include all those factors that underpin their unique operation due to their public purpose that could dramatically damage and threaten to destabilise the world economy. Therefore, the core dimension of banks' corporate governance is effective procedures and rules so as to protect the public (*vis-à-vis* depositors and creditors) and maintain financial stability. *See, e.g.,* Ciancanelli, P., and J. A. R. Gonzalez, 'Corporate Governance in Banking: a Conceptual Framework' (European Financial Management Association Conference 2000, Athens).
[4] *See, e.g.,* Shleifer, A. and R. W. Vishny, 'A Survey on Corporate Governance' (1997) 52 (2) J Fin 737, 737.

they rather fall under the scope of company law, commercial law, public law, capital markets law or to a combination of all these. Such broad nature gives rise to difficulties when conducting analysis of legal documents at a national level.[5]

Third, adjacent to the broad subject matter of the corporate governance is its interdisciplinary character, since it is not a purely legal term. Conversely, governance has strong social and economical extensions, which entail an interdisciplinary approach in order to fully capture most of its aspects. The most evident interaction of disciplines is that of law and economics, where the fundamental role of legal norms and foundations is reflected to the well functioning of market economies.

The Limitations of this Study

In seeking to discuss corporate governance issues, the study's purpose is constrained to preliminary and general judgments. This is because corporate governance as a concept is a dynamic and interdisciplinary one, which is constantly being developed and formed in a rapidly changing legal and financial environment where caution dictates that no single answer as to corporate governance concerns is available.

Accordingly, the study primarily examines the current state of the law and institutions therein as to Greece. It, primarily, describes how these have

[5] For instance, the Corporate Governance Law 3016/2002, as amended [hereinafter Corporate Governance Law of 2002] (*See, e.g.,* Hellenic Law 3016/2002 *on Corporate Governance, Board Remuneration and Other Issues*, Official Government Gazette 110/ 17.05.2002 as amended by Law 3091/2002, Official Government Gazette A330/ 24.12.2002) is not exclusively a capital market law statute, not least of the nature of its subject matter, but it also overlaps with company law. This duality is an obstacle to be negotiated ahead of its future company law or capital markets law codification projects. *See, e.g.,* Athanassiou, P., 'Recent Developments in Greek Capital Markets Law' (2005) 16 (4) EBLR 893, 898.

been implemented and the extent to which they constrain or support the achievement of the corporate governance objectives, as defined by the local legal framework. Given that the experience of the corporate governance rules in Greece is at an infant stage, some of the conclusions are tentative and preliminary, although a strong case can be made that Greece follows closely with the increased international and European corporate governance activism.

A Brief Historical Reference to the Emergence of the Corporate Governance Concept within a Global Theoretical Context

On the premises that the corporate governance concept relates to the organization of the production process, the first signs of adherence to corporate governance principles were witnessed parallel to the development of capitalism. Since ancient times, a number of countries had applied a sort of corporate governance practices, aiming, in particular, to maximize their profits and secure the return of their investment. Notwithstanding that the vocabulary may be new, the debate on corporate governance and its pursuit is quite old and may date back to the introduction of joint stock companies.

Similarly, in the context of the organization of the ancient Greek public relations, the great philosopher Plato[6] seems to have been the first to have identified the importance of profitability and optimization of the production process.[7] The quest for good corporate governance goes back in time with the participation of employees to the Town Council's meetings, i.e.

[6] In Plato's writings, *see, e.g.*, 'The Republic' (390 BC) and 'The Laws' (347 BC), are debates concerning the best possible form of government, where he completes his sketch on the form and the institutions (constitution) of the state.
[7] *See, e.g.*, Mouzoulas, S., *Corporate Governance: International Experience, Greek Reality* (in Greek) (Sakkoulas Publications, Athens 2003).

the decision-making process, as the first aspect of corporate governance. Evidence suggests that as long as employees (at that time they were primarily land workers) participated in the decision making process they appeared to be more willing to take up new tasks and new posts.[8]

What is paradoxically interesting in the case of the Greek corporate governance affairs is the fact that although since the first signs of adherence to corporate governance principles were marked in the period of the great philosopher Plato, it was only after the late 1990s that the issue of corporate governance was formally launched in the Greek corporations. In practice, in 1999 the recommendations of the Mertzanis Report[9] introduced for the first time in a single legal document the corporate governance principles (which were, however, not binding) and urged Greek corporations to comply with such standards. Unfortunately, there are no adequate resources to explain why during such a historical leap no reference is made to corporate governance issues. However, a rough explanation that can partially clarify the initiation of the corporate governance debate in the late 1990s might be the existence of intensive competitive forces as a result of Greece's membership of international fora and cooperative organisations. More particularly, such forces were evident in the Greek market especially after the 1960s and 1980s, when Greece joined a number of significant international and European fora for international cooperation and the promotion of economic development. In 1960, Greece became a founding member of the OECD[10] and in 1981 became

[8] *See, e.g.,* Mouzoulas, S., *Corporate Governance: International Experience, Greek Reality* (in Greek) (Sakkoulas Publications, Athens 2003).
[9] *See, e.g.,* Committee on Corporate Governance in Greece (under the coordination of the HCMC) 'Principles on Corporate Governance in Greece: Recommendations for its Competitive Transformation' (The Mertzanis Report) 1999 Athens, Greece.
[10] Greece signed the OECD Convention founding the OECD on 14 December 1960, thereby pledged its full dedication to achieving the Organisation's fundamental aims.

the 10th EU member state. As is mentioned in more detail below such memberships place Greece on a similar footing with other developed countries and consequently the pressures to stay competitive are intense.

Therefore, Greece, as explored below, follows closely the OECD particularly in the area of corporate governance, which is evident from two interrelated facts. One, it is that the Mertzanis Report, as the first Greek corporate governance code, was published in 1999, which coincides with the year that the OECD Corporate Governance Principles were also introduced. Second, it is that the Mertzanis Report seems to resemble the contents of the OECD Corporate Governance principles to such an extent that the Mertzanis Report is regarded as a translation of those principles into Greek. The latter fact reflects an important intuition and quest of this thesis, which is not only to confirm a moderate level of internalisation of international corporate governance standards in the Greek corporate market, but significantly to explore those country-specific reasons that seem to constrain the full internalisation of the those corporate governance principles, which although rather new as formal principles, old in their inception.

2. A GENERAL DISCUSSION ON THE IMPORTANCE OF CORPORATE GOVERNANCE

Positive Analysis: Why Care about Corporate Governance?

The reasons that make the debate on corporate governance a timely one rest primarily on the following reasons: (a) the liberalisation and deregulation of capital markets around the world; (b) the increased financial sophistication of capital markets; (c) the existence of more players in the markets; (d) the complexity and interconnection of markets (cross-sector and cross-border); and (e) the subsequent increased volatility of the new world, which results in effects to be instantaneous both at cross-border and cross-sector dimension visible.[11]

Basically, the increased importance of good corporate governance has been marked by the work of the Organisation of Economic Cooperation and Development (OECD) that is significant in that area. Additionally, such importance has been documented by the examination of the positive relationship between good corporate governance and corporate efficiencies. Therefore, in order to fully capture the importance of corporate governance, a review of those positive efficiencies is undertaken, coupled with reference to the significant OECD work.

This part of the study is to build on the overall debate on the added value of corporate governance for corporations and shareholders by showing how corporate governance norms help to make corporations and shareholders better off in terms of business development and adequate protection of their rights, respectively. Toward this end, the two equally important and indispensable objectives of corporate governance are described. First is the enhancement of the performance of corporations and business development, and second is the assurance of the 'conformance' of firms towards protecting shareholders' interests.[12]

As to the first objective, good corporate governance facilitates and stimulates the better performance of public companies by creating and

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[11] *See, e.g.*, Houben, A., J. Kakes, and G. Schinasi, 'Toward a Framework for Safeguarding Financial Stability' (2004) IMF Working Paper 101, at 19-20.
[12] *See, e.g.*, Oman, C. P., 'Corporate Governance and National Development' 180 OECD Technical Paper (2001).

maintaining a business environment that motivates managers and financiers to maximise firms' operational efficiency; returns on investment; and long-term productivity growth. This can be the result of more efficient and better management practices; better asset allocation; better labour policies; higher degree of corporate responsibility;[13] or other efficiency improvements that good corporate governance promotes.

Accordingly, the objective of ensuring the 'conformance' of firms with investors' and society's interests and expectations can be in principle achieved by limiting the above power and the dramatic waste of corporate resources; the tunnelling of assets;[14] the moral hazard problems; the so-called 'principal-agent' conflict and the self-serving behaviour of managers.[15] Hence, the pursuing of the 'conformance' end creates optimal conditions for sound and prudent operation of public companies.

From a principal-agent theoretical perspective, if the separation of ownership from control creates agency problems, then the corporation finds in turn adaptive mechanisms to mitigate those agency costs. Corporate governance mechanisms are introduced to solve those problems. In turn, it is evidenced that the fittest organisational structures, e.g. strong corporate governance arrangements, make the modern corporation as efficient as it can be.[16]

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[13] A high degree of corporate responsibility can ensure good relationships with all the firm's stakeholders and thereby improve the firm's overall financial performance. *See, e.g.*, Claessens, S., 'Corporate Governance and Development: Review of the Literature and Outstanding Research Issues' (GCG Forum Donors Meeting, 13 March 2003, The Hague).
[14] *See, e.g.*, Johnson, S., R. La Porta, F. Lopez-de-Silanes, and A. Shleifer, 'Tunnelling' (2000) 90 (2) Am Econ Rev: Papers & Proceedings 22 (The authors describe the various forms of tunnelling on the basis of the legal principles of duty of care and duty of loyalty).
[15] *See, e.g.*, Oman, C. P., 'Corporate Governance and National Development' 180 OECD Technical Paper (2001).
[16] *See, e.g.*, Roe, M. J., 'A Political Theory of American Corporate Finance' (1991) 91 (1) Colum L Rev 10, 15.

Again, on the premises of the principal-agent theory, shareholders assume a 'passive role' given that they do not participate in the corporate decision-making process.[17] Yet, since the ultimate concern of shareholders is the protection of their rights, solving the agency problem, they reasonably choose to invest their money in corporations that are known to have developed and have applied solid corporate governance rules. Such rules are believed to protect the interests and rights of shareholders and minimise managerial expropriation. Hence, the application of strong corporate governance reflects an important and effective mechanism for shareholders enabling them to be compensated and protected for their 'passive role' in the corporate affairs.

Therefore, the added value of corporate governance is linked with better corporate performance by preventing the expropriation of controlling shareholders and ensuring better decision-making.[18] Moreover, good corporate governance means little expropriation of corporate resources by managers, which contributes to better asset allocation and better performance. As investors and lenders will be more willing to put their money in firms with good corporate governance, those businesses will face lower costs of capital, which reflects another source of better performance. Implications for the economy as a whole will be witnessed: economic growth will be more sustainable, because the economy is less vulnerable to systemic risk.

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[17] *See, e.g.*, Millstein, I. M., 'The Board – Governing Beyond Where the Law Ends' (address to the ICGN 2006 Annual Conference, Washington DC, 5 July 2006); and Shleifer, A., and R. W. Vishny, 'A Survey on Corporate Governance' (1997) 52 (2) J Fin 737.

[18] The questionnaire survey conducted by S. W. Nam and I. C. Nam for companies in Indonesia, the Republic of Korea, Malaysia and Thailand for the period July-October 2003 documented that for all companies surveyed, corporate governance scores were strongly associated with firm performance, as measured by Tobin's q (the ratio of market value to book value of a firm). *See, e.g.*, Nam, S. W., and I. C. Nam, *Corporate Governance in Asia: Recent Evidence from Indonesia, Republic of Korea, Malaysia and Thailand* (Asian Development Bank Institute 2005), at 89-125.

Conversely, weak corporate governance rules provide fertile ground for corruption and fraud.[19] In a similar vein, Newell and Wilson suggest that in theory good corporate governance should increase the market valuation of companies by improving their financial performance, reducing risk that boards will make self-serving decisions and generally raising investor confidence.[20]

Significant empirical studies that measure the impact of the quality of corporate governance in firm's performance have been conducted, *inter alia*, by Claessens, Djankov, Fan and Lang for nine East Asian countries,[21] Johnson, Boone, Breach and Friedman for 25 emerging markets;[22] Black for Russia;[23] Mitton for Indonesia, Korea, Malaysia, the Philippines and Thailand;[24] Campos, Newell and Wilson for six emerging markets;[25] Klapper and Love for 25 emerging markets in the region of Asia;[26] Black, Jang and

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[19] *See, e.g.*, Nam, S. W., and I. C. Nam, *Corporate Governance in Asia: Recent Evidence from Indonesia, Republic of Korea, Malaysia and Thailand* (Asian Development Bank Institute 2005), at 89-125.

[20] *See, e.g.*, Newell, R., and G. Wilson, 'A Premium for Good Governance' (2003) The McKinsey Quarterly, No. 3.

[21] The study shows that higher cash flow rights of the controlling shareholders are associated with higher market valuation, but higher voting rights of the controlling shareholders correspond to lower market valuation. *See, e.g.*, Claessens, S., S. Djankov, J. P. H. Fan and L. H. P. Lang, 'Expropriation of Minority Shareholders: Evidence from East Asia' (1999) Wld Bank Working Paper 2088 at 15-21.

[22] The study finds that the effectiveness of protection for minority shareholders in 25 emerging markets explains more of the variation in exchange rated and stock market performance during the Asian crisis. *See, e.g.*, Johnson, S., P. Boone, A. Breach, and E. Friedman, 'Corporate Governance in the Asian Financial Crisis' (2000) 58 (1-2) J Fin Econ 141, 150-151 and 171-178.

[23] *See, e.g.*, Black, B. S., 'Does Corporate Governance Matter? A Crude Test Using Russian Data' (2001) 149 (2) U Pa L Rev 2131.

[24] The main finding of this study is that several firm-level variables related to corporate governance had a significant effect on firm performance during the Asian crisis of 1997-1998. *See, e.g.*, Mitton, T., 'A Cross-Firm Analysis of the Impact of Corporate Governance on the East Asian Financial Crisis' (2002) 64 (2) J Fin Econ 215, 227-234.

[25] *See, e.g.*, Campos, C., R. Newell and G. Wilson, 'Corporate Governance Develops in Emerging Markets', (2002) McKinsey on Finance (Winter) 15-18.

[26] *See, e.g.*, Klapper L. F., and I. Love, 'Corporate Governance, Investor Protection and Performance in Emerging Markets' (2002) Wld Bank Pol Res Working Paper 2818.

Kim for the Republic of Korea;[27] and Baek, Kang and Park.[28] Notwithstanding that each study has its own way of constructing corporate governance scores, all of them find that good corporate governance practices are strongly correlated with higher firm value.

Furthermore, the literature documents also the increasing importance of corporate governance for capital and securities markets, evidencing good securities laws (e.g. extensive disclosure rules and strong legal enforcement) as most beneficial for market development. In more precise terms, a study shows that good securities laws and sound corporate governance rules influence the size of capital markets and the number of Initial Public Offerings (IPO's).[29] Therefore, good corporate governance practices in public companies, followed by greater credibility and transparency can reflect an increase in IPO's. Additionally, in the same study, it is demonstrated that good corporate governance rules are not only linked with higher levels of a company's credibility, but also with increased and easier access to financing, with the latter relationship also supported by La Porta, Lopez-de-Silanes, Shleifer and Vishny[30] and Claessens.[31]

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[27] *See, e.g.*, Black, B. S., H. Jang, W. Kim, 'Does Corporate Governance Matter? Evidence from the Korean Market' (2003) Stanford Law School, John M. Olin Program in Law and Economics, Stanford, CA Working Paper 209.

[28] The authors, in line with the findings of Mitton, T., 'A Cross-Firm Analysis of the Impact of Corporate Governance on the East Asian Financial Crisis' (2002) 64 (2) J Fin Econ 215, 227-234, find that corporate governance has a significant influence on firm-level performance in a crisis and further suggest that the negative impact is greater on firms in which controlling shareholders have stronger incentives and means to expropriate resources. *See, e.g.*, Baek, J. S., J. K. Kang and K. S. Park, 'Corporate Governance and Firm Value: Evidence from the Korean Financial Crisis' (2004) 71 (2) J Fin Econ 265, 270.

[29] *See, e.g.*, La Porta, R., F. Lopez-de-Silanes, and A. Shleifer, 'What Works in Securities Laws?' (2006) 61 (1) J Fin 1.

[30] *See, e.g.*, La Porta, R., F. Lopez-de-Silanes, A. Shleifer, and R. Vishny, 'Law and Finance' (1998) 106 J Pol Econ 1113.

[31] *See, e.g.*, Claessens, S., 'Corporate Governance and Development: Review of the Literature and Outstanding Research Issues' (GCG Forum Donors Meeting, 13 March 2003, The Hague).

The literature, then, identifies a positive relationship between good corporate governance norms and the cost of capital and corporations' valuation. This additional channel through which corporate governance matters demonstrates that outsiders are less willing to provide financing and if they are less assured that they will get an adequate rate of return, they charge higher rates. Therefore, better corporate governance leads to lowering of the cost of capital and associated higher firm valuation.[32] In essence, when firms have greater and easier access to external financing, this in turn can lead to larger investments, lower capital cost, higher growth, greater employment creation and poverty reduction.

Moreover, another dimension of the positive efficiencies of good corporate governance is framed within the context of Mergers and Acquisitions negotiations and the overall realisation of their strategy. More particularly, it has been argued that corporate governance considerations (e.g. the quality of the corporate governance systems of the acquired company) are taken into consideration from the acquirer company. This is particularly reflected in the words of Peter Clapman, former senior vice-president and chief counsel for corporate governance at TIAA-CREF, who argued that *'when global investors look at deals, particularly cross-border deals, they will often factor corporate governance issues into the equation, and these may have a practical effect on price and value'*.[33]

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[32] For the positive correlation of good corporate governance and lower cost of equity capital, *see, e.g.,* Ashbaugh-Skaife, H., D. W., Daniel, and R. LaFond, 'Corporate Governance and the Cost of Equity Capital' (2004) SSRN, at 5, and the references contained. (The authors posit that better governance impacts a firm's cost of equity capital by mitigating agency risks driven by the problems of moral hazard and adverse selection. The results of the paper support the general hypothesis that firms with better governance present less agency risk to shareholders resulting in lower cost of equity capital).

[33] *See, e.g.,* Bris, A., and C. Cabolis, 'The Value of Investor Protection: Firm Evidence from Cross-Border Mergers' (2004) Yale International Centre for Finance, Working Paper 32; and

On the contrary, generally speaking, it is claimed that weak corporate governance arrangements can have an adverse impact on merger and acquisition activity. As Claessens notes, the volume of mergers and acquisitions activity and the premium paid are significantly larger in countries with better investor protection, which is supported through better corporate governance framework. Therefore, an active market for mergers and acquisitions, which is important for growth, innovation, and development, usually arises in countries with good corporate governance regimes and stronger investor protection.[34]

The importance of good corporate governance is also revealed by the McKinsey Global Investor Opinion Survey, which shows additional reasons for the increased interest on corporate governance.[35] The survey finds that the application of good corporate governance systems is a decisive parameter for institutional investors' decision and they put it on a par with financial indicators when evaluating investment decisions. Accordingly, an overwhelming majority of investors are prepared to pay a premium for

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Bris, A., and C. Cabolis, 'Integrating Corporate Governance Systems' *Financial Times* (5 October 2006).

[34] *See, e.g.*, Claessens, S., 'Corporate Governance and Development: Review of the Literature and Outstanding Research Issues' (GCG Forum Donors Meeting, 13 March 2003, The Hague). It is important to note that one of the main arguments for carrying out mergers and acquisitions has been that they create synergies. However, there is growing literature that examines the extent to which companies have overestimated the potential of synergies and have underestimated the possible negative impact of mergers and acquisitions on the process of innovation and development. As this issue exceeds the scope of the present analysis, an important resource for further reflection on this dispute is that of Cassiman, B., and M. Ueda, 'Mergers & Acquisition and Innovation: A Conceptual Framework' in Cassiman, B., and M. G. Colombo (eds.), *Mergers & Acquisition: The Innovation Impact* (Edward Elgar Publishing, UK 2006).

[35] This survey confirms the findings of the 1996 McKinsey survey (*See, e.g.*, Felton, R. F. A. Hudnut, and J. van Heeckeren, 'Putting a Value on Corporate Governance' (1996) 4 The McKinsey Quarterly 170) on corporate governance, where the 2/3 of investors asked stated that: 'they would pay more for stock of companies that are well governed. Specifically, among those willing to pay more for good governance, the average premium specified was 16%'. *See, e.g.*, Newell, R., and G. Wilson, 'A Premium for Good Governance' (2003) The McKinsey Quarterly, No. 3.

companies exhibiting high governance standards.[36] Finally, several studies document that better corporate governance can lead not only to improved rates of return on equity and higher firm valuation but also to higher profits, stronger sales growth and thus generally creating more wealth.[37]

In the context of further measuring the positive effects of corporate governance arrangements the work of the OECD is significant. Therefore, for the sake of completeness, in the following lines reference to the important OECD work is made, in an attempt to discuss those positive corporate governance efficiencies that the OECD has identified. The importance of such analysis rests on two vital and interrelated issues. One, it is on illustrating the set of the reasons that make corporations, *vis-à-vis* Greek companies, to have a strong interest in solid corporate governance arrangements. Two, it is to define that for the purposes of the present research the OECD corporate governance principles are recognised as benchmarks in that area.[38]

The OECD, as the international organisation that has extensively reviewed and examined corporate governance issues, has raised awareness of the importance of corporate governance for public companies and the economy at large.[39] In this context, the OECD Corporate Governance

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[36] Premiums averaged 12-14% in North America and Western Europe; 20-25% in Asia and Latin America; and over 30% in Eastern Europe and Africa. *See, e.g.,* Newell, R., and G. Wilson, 'A Premium for Good Governance' (2003) The McKinsey Quarterly, No. 3.

[37] *See, e.g.,* Joh, S. W., 'Corporate Governance and Firm Profitability: Evidence from Korea before the Economic Crisis' (2003) 68 (2) J Fin Econ 287 (the work addresses the issue of how the corporate governance structure affected firm profitability before the Asian financial crisis. It was found that firm performance had been deteriorating even before the crisis occurred. The work concludes that if more studies evidence the adverse effects of poor corporate governance, then policies that improve a country's corporate governance can support its aggregate economic growth and stability.), and Black, B. S., H. Jang, W. Kim, 'Does Corporate Governance Matter? Evidence from the Korean Market' (2003) Stanford Law School, John M. Olin Program in Law and Economics, Stanford, CA Working Paper 209.

[38] *See, e.g.,* OECD, (2004), 'OECD Principles of Corporate Governance' [hereinafter the OECD Principles].

[39] *Id.*

Principles stress the importance for corporations to apply basic principles of good corporate governance.[40]

Corporate governance is recognised as a key element in improving economic efficiency and growth, as well as enhancing investor confidence. Good corporate governance should provide proper incentives for the board and management to pursue objectives that are in the interests of the company and its shareholders and should facilitate effective monitoring. The introduction of an effective corporate governance system, within an individual company and across an economy as a whole, helps to provide a degree of confidence that is necessary for the proper functioning of a market economy. As a result, the cost of capital is lower and firms are encouraged to use resources more efficiently, thereby underpinning growth.[41]

Furthermore, the OECD considers the application of good corporate governance principles as a decisive factor for investment decisions. In line with La Porta, Lopez-de-Silanes, Shleifer and Vishny[42] and Claessens,[43] who document the positive correlation between good corporate governance and access to financing, the OECD work supports this relationship in its international dimension. If corporations are to reap the full benefits of the global capital market, where a larger pool of investors is available, corporate governance arrangements must be credible, well understood across borders and in conformity with internationally accepted principles.[44]

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[40] *See, e.g.*, OECD, (2004), 'OECD Principles of Corporate Governance'.
[41] *Id.*
[42] *See, e.g.*, La Porta, R., F. Lopez-de-Silanes,A. Shleifer, and R. Vishny, 'Law and Finance' (1998) 106 J Pol Econ 1113.
[43] *See, e.g.*, Claessens, S., 'Corporate Governance and Development: Review of the Literature and Outstanding Research Issues' (GCG Forum Donors Meeting, 13 March 2003, The Hague).
[44] *See, e.g.*, OECD, (2004), 'OECD Principles of Corporate Governance'.

In conjunction with the above, an OECD study documents strong correlation between sound macroeconomic policies and robust microeconomic foundations. Countries seem to have shifted their attention towards the micro-economic foundations and structures, *vis-à-vis* corporate governance, in order to enhance their economic performance.[45]

The OECD Corporate Governance Principles and, more particularly, the one that refers to the disclosure of information and transparency, contribute to the debate on the positive relationship between good corporate governance and credibility of a company. According to that principle, it is vital that shareholders and creditors have access to important information on key aspects of the business, so as to significantly reduce their information uncertainties.[46] Against this backdrop, increased transparency, accountability and credibility can lead not only to a better flow of external finance *vis-à-vis* foreign direct investment but can also enhance the stability of financial markets. Additionally, Shleifer and Vishny provide further evidence towards this argument, who document that undeveloped corporate governance mechanisms can substantially retard the flow of external capital to firms.[47]

Overall, the contribution of the OECD as a supporter of the benefits of the good corporate governance is reflected for the first time with the release of the 'Corporate Governance Principles' in 1999.[48] Since then, these Principles

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[45] *See, e.g.,* Maher, M., and T. Andersson, 'Corporate Governance: Effects on Firm Performance and Economic Growth' (1999) OECD.

[46] '*Corporate governance framework should ensure the full, timely and detailed disclosure of information on all material matters, including financial situation, performance, ownership structure and governance of a corporation'. See, e.g.,* OECD, (2004), 'OECD Principles of Corporate Governance'.

[47] *See, e.g.,* Shleifer, A. and R. W. Vishny, 'A Survey on Corporate Governance' (1997) 52 (2) J Fin 737, 738 citing Barca, F., 'On Corporate Governance in Italy: Issues, Facts and Agency' (1995) Bank of Italy (manuscript) on the Italian corporate governance mechanism. Also, *see, e.g.,* Pagano, M., F. Panetta, and L. Zingales, 'Why Do Companies Go Public? An Empirical Analysis' (1998) 53 (1) J Fin 27.

[48] *See, e.g.,* OECD, (1999), 'OECD Principles of Corporate Governance'.

have become the international benchmark for policy makers, investors, corporations and other stakeholders worldwide. They have advanced the corporate governance agenda and provided specific guidance for legislative and regulatory initiatives in both OECD and non-OECD countries, forming the basis for a number of reform initiatives, both by governments and the private sector.

In view of corporate scandals, failures and wrongdoings, the OECD Council Meeting at Ministerial Level in 2002 agreed to survey the developments in OECD countries and to assess the 1999 Principles in light of developments in corporate governance. It was concluded that the 1999 Principles should be revised to take into account new developments and concerns. Therefore, on 22 April 2004, the OECD governments approved a revised version of the OECD Principles of Corporate Governance.[49]

The OECD Principles, as amended, focus on publicly traded companies and intend to assist governments in improving the legal, institutional, and regulatory framework that underpins corporate governance. They also provide practical guidance and suggestions for stock exchanges, investors, corporations, and other parties that have a role in the process of developing good corporate governance.

The OECD Principles are not prescriptive or binding, but take the form of recommendations that each country can respond to as best fits its own traditions and market conditions. They aim at the development of best practices in corporate governance since they constitute a fundamental factor in enhancing economic growth partially through the consolidation of domestic

[49] *See, e.g.*, OECD, (2004), 'OECD Principles of Corporate Governance'.

and international investors' confidence. Hence, they provide a spectrum of directions, not only of micro- but also of macro-economic value, concerning the relationships between a company's shareholders, its board of directors, its management and its other stakeholders, meaning the parties maintaining a broader interest and confidence in company's overall performance, since the objective of a corporation should be defined more widely than shareholders' profit-maximisation.[50]

Overall, since 1999, the OECD Principles have been widely adopted as a benchmark for good practice in corporate governance. The Financial Stability Forum has designated the OECD Principles as one of the 12 key standards for sound financial systems.[51] The OECD Principles also provide the basis for an extensive program of cooperation between OECD and non-OECD countries and underpin the corporate governance component of World Bank/ International Monetary Fund (IMF) Reports on the Observance of Standards and Codes (ROSC).[52]

Significantly, the aforementioned findings document the importance of good corporate governance for public companies, which also abide by specific listing requirements and other securities regulations with the emphasis on increased transparency. Although it well exceeds the scope of the present research, an interesting issue for further elaboration is the review of the importance of strong corporate governance arrangements with regard to financial and credit institutions.

[50] *See, e.g.,* Alexakis, S., 'Incorporation of OECD Principle of Corporate Governance in Greek Securities Legislation' (2005) *LawNet.gr (e-report).*
[51] *See, e.g.,* OECD, (2004), 'OECD Principles of Corporate Governance'.
[52] *Id.*

Such importance has come to the fore by recent banking and financial scandals.[53] Such scandals have crystallised not only the important role that banks play in the economy, since they are placed at the heart of financial systems, but also that they are different from other public companies on account of their public purpose[54] and their risk shifting ability. A testament of the importance of corporate governance rules in banks is the publication of the Basel work on *'Enhancing Corporate Governance in Banking Organisations'*,[55] which mainly draws on recommendations based on the OECD Principles.[56]

Finally, the importance of good corporate governance is particularly highlighted and more attention is now directed to the application of concrete corporate governance principles into new domains, such as on banks, bank holding companies, and conglomerates.[57]

Negative Analysis: Explaining the Implications

One building block beyond the focus on the importance of good corporate governance arrangements, the analysis now shifts to discuss the implications of inadequate and weak corporate governance structures. In essence, the objective of this *negative analysis* is twofold. First, it is proposed

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[53] By way of example, the UK banking scandals in the 1990s, such as that of the British and Commonwealth Bank in 1990; the Bank of Credit and Commerce International in 1992-1993; and the collapse of the Barings Bank in 1995; provide unique insight.

[54] Banks typically receive approximately 90 percent of their financing through debt, which tends to be in the form of deposits from multiple depositors usually lacking financial literacy. *See, e.g.,* Macey, R. J., and M. O' Hara, 'The Corporate Governance of Banks' (2003) 9 (1) FRBNY Econ Pol Rev 91, 97.

[55] *See, e.g.,* Basel Committee on Banking Supervision, 'Enhancing Corporate Governance for Banking Organizations' (1999) Basel.

[56] *See, e.g.,* OECD, (2004), 'OECD Principles of Corporate Governance'.

[57] *See, e.g.,* Adams, R., and H. Mehran, 'Is Corporate Governance Different for Bank Holding Companies?' (2003) 9 (1) FRBNY Econ Pol Rev 123; and Walker, G. A., *International Banking Regulation Law, Policy and Practice* (Kluwer Law International, The Hague 2001).

to discuss the implications of corporate failures as a result of weak corporate governance structures and the responses to them using as case studies the most recent corporate scandals occurred in the US and Europe. Second, it is proposed to try to identify some of the factors that contributed to those failures.

Apparently, these scandals had dramatic effects for the organisation of modern corporations and showed that every one of the mechanisms set up to provide checks and balances failed at the same time. The findings of this negative analysis show, *inter alia,* that it is difficult for corporations to remain afloat and profitable if there are no concrete corporate governance arrangements in place. Against this backdrop, attention is placed on the corporate scandals in the USA and Europe and the prompt regulatory reforms that were effectuated. In addition, reference to the OECD initiatives is made in an effort to unveil the increased importance of corporate governance, especially after the revelations of corporate scandals amid corporate governance weaknesses. The main purpose of that discussion is dual. First, it is to further explain the significance of good corporate governance arrangements, as marked by the implications of those corporate failures. Second, the brief description of the prompt regulatory reforms that followed provides additional testament to the fact that corporate governance matters for both corporations and the economy at large.

In a narrower context of family firms, any corporate governance arrangements must include also the concrete succession plans, as will be analysed in more detail. The latter is particularly illustrated by the analysis of the family firms' failure of the Parmalat in Italy and of Adelphia in the USA.

Furthermore, the significance of this negative analysis rests on the fact that it serves as a useful reference point, aiming to underline those indications that drive or will be able to drive governments, regulators, and policy makers, including Greece, to respond to demands for stronger corporate governance. Greece can learn significant lessons from those scandals occurred in the US and Europe, respectively.

More specifically, the recent corporate scandals in the USA and in Europe (e.g. Italy) revealed a number of important conditions necessary for a strong corporate governance framework. Absent those conditions, defaults were unable to be averted. Those critical components are considered, *inter alia*, to be the specific corporate culture that was characterised by corruption, and the weak role of gatekeepers, coupled with the lack of whistle-blowing mechanisms to facilitate making their voices heard.

The importance of corporate governance became dramatically clear in 2001 as a series of corporate breakdowns, frauds and other allegations about negligence and abuse, from accounting fraud to embezzlement, resulted in the loss of billions of dollars of shareholders wealth.[58] The revelation of corporate wrongdoings in companies like Enron, Tyco, WorldCom, Adelphia, Parmalat and Royal Dutch/Shell, was shocking due to the fact that these companies had got high marks -from almost all commentators and regulators- for good corporate governance practices.[59] Hence, those corporate governance failures in the USA and Europe led to drastic reforms not only in the directly affected

[58] Professor Paul Tiffany compared the top managers of these corporations with the so-called 'robber barons' of the 19th century. *See, e.g.*, Tiffany, P., 'History of Corporate Scandals' (Interview) *The Washington Post* (31 July 2002).

[59] The description of the facts of those scandals exceeds the scope of the present research. For a comprehensive deposition of the facts, *see, e.g.*, Monks, R. A. G., and N. Minow, *Corporate Governance* (3rd edn, Blackwell Publishing Ltd 2004), at 489-493, 501-511.

financial markets but rather to a worldwide scale, aiming to offer ostensible remedies for future *'Enronesque behaviours'*.

The need for legal and institutional reform to restore and enhance confidence in the sound function of corporations brought good corporate governance to the fore of the discussion. Such reforms will eventually establish better international standards, thereby enhancing corporate governance norms around the globe.

In the USA, the most important step was the enactment of the Sarbanes-Oxley Act[60] that reflected US Congress's attempt to address, *inter alia,* the gatekeeping concerns, with particular emphasis on the audit profession and on other main corporate governance mandates.[61] On reflection, it is evident that the failure of gatekeepers, audit firms, some consultants, members of the corporate board, Wall Street banks, some law firms, and regulatory agencies shaped such malfeasance. At its core, the Enron failure, for example, demonstrated corporate governance deficiencies in that the internal control mechanisms were short-circuited by conflicts of interests that enriched certain managers at the expense of shareholders.[62]

Just as the Great Depression ushered in a period of intense reform, when the US companies collapsed, congressional, state attorney general, the Securities Exchange Commission (SEC) and Grand jury investigations took place. The SEC became more vigilant, arrests, indictments, fines and jail

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[60] *See, e.g.,* US House of Representatives, 'Public Company Accounting Reform and Investor Protection Act of 2002' (The Sarbanes-Oxley Act of 2002) Public Law No. 107-204, 116 Stat. 745 (30 July 2002).

[61] Due to space limitations, the present analysis does not include other specific reforms addressing the various gatekeepers' concerns, such as for instance, the audit profession; the creation of the Public Company Accounting Oversight Board (PCAOB); the lawyers' new reporting obligations; or the new director independence requirements.

[62] *See, e.g.,* International Swaps and Derivatives Association, 'Enron: Corporate Failure, Market Success' 17th Annual General Meeting (17 April 2002).

sentences followed, but most importantly the US President demanded changes. Against this background, the New York Stock Exchange (NYSE) adopted new corporate governance rules, [63] the SEC adopted new disclosure requirements and finally, the US Congress, under enormous pressure to respond to the domino-like effects of American corporations amid allegations of corruption of unprecedented scope, passed the Sarbanes-Oxley Act in 2002.[64]

The Sarbanes-Oxley Act was US Congress's attempt to address, *inter alia,* the gatekeeping concerns with particular emphasis on the role of auditors. Against this objective, its principal reform includes the auditor independence provisions that restrict the provision of non-audit services to public audit clients.[65] In principle, the underlying rationale for banning that

[63] Among the most important changes that the NYSE listing standards proposed in June 2002 were: 1. the increase of the role and authority of independent directors; 2. the clarification of the definition of 'independent' director, the addition of new audit committee qualification requirements; 3. raising the awareness and focus on good corporate governance, 4. disclosure of a code of business conduct and ethics for directors, officers and employees, and 5. promptly disclose any waivers of the code for directors or executive officers. *See, e.g.,* New York Stock Exchange, 'Corporate Governance Rules, as codified in s. 303A of the NYSE's Listed Company Manual' (2002).

[64] President George W. Bush when signed the Sarbanes-Oxley Act created the most radical redesign of federal securities laws since the 1930s (*see, e.g.,* Lipton, M., 'Bubbles and their Aftermath', address to the Commercial Club of Chicago, Illinois, November 2002 http://www.thecorporatelibrary.com/special/misc/700626_4.pdf) and advanced the disclosure requirements to substantive corporate governance mandates (*see, e.g.,* Romano, R., 'The Sarbanes-Oxley Act and the Making of Quack Corporate Governance' (2005) 114 Yale L J 1521). For a critique of the Sarbanes-Oxley Act corporate governance provisions (the principal argument rests on the assertion that the SOX corporate governance mandates were not carefully considered by Congress, and in particular, they were not evaluated in light of the empirical literature questioning their efficacy. Accordingly, the central policy recommendation is that the corporate governance provisions of the Sarbanes-Oxley Act should be stripped of their mandatory force and rendered optional for registrants. Such finding is consistent with empirical studies that view efficacious corporate and securities laws as the product of competitive legal systems. Notably, many of the substantive corporate governance provisions in the Sarbanes-Oxley Act were not in fact regulatory innovations devised by Congress to cope with deficiencies in the business environment in which Enron and WorldCom failed. Rather, they may more accurately be characterised as recycled ideas advocated for quite some time by corporate governance entrepreneurs. *See, e.g.,* Romano, R., 'The Sarbanes-Oxley Act and the Making of Quack Corporate Governance' (2005) 114 Yale L J 1521, 1523; and Bainbridge, S. M., 'A Critique of the NYSE's Director Independence Listing Standards' (2002) 30 Sec Reg L J 370.

[65] *See, e.g.,* US House of Representatives, 'Public Company Accounting Reform and Investor Protection Act of 2002' (The Sarbanes-Oxley Act of 2002) Public Law No. 107-204, 116

practice was advanced on the premises that the provision of non audit services compromises auditor's independence and therefore prohibited.[66] Additionally, Section 301 of the Sarbanes-Oxley Act creates specific structure and roles for audit committee by requiring all listed companies to have audit committees composed entirely of independent directors.[67]

Apart from aiming to enforce the independence of external auditors, the purpose of the Sarbanes-Oxley Act is also to reinforce the duties of the Chief Executive Officer (CEO) and the Chief Financial Officer (CFO) by imposing strict penalties for misrepresenting the financial position of their companies in quarterly and annual reports. More particularly, Section 302 requires the CEO and CFO to certify that the company's periodic reports do not contain material misstatements or omissions and 'fairly represent' the firm's financial conditions and results of operations. By way of executive certification of financial statements, CEO and CFO are held responsible for establishing, maintaining, and evaluating an effective system of internal

Stat. 745 (30 July 2002), s. 103: 'Auditing, Quality Control and Independence Standards and Rules' and s. 201: 'Services outside the Scope of Practice of Auditors; Prohibited Activities' that prohibit accounting firms from providing a list of specified non audit services to firms that they audit. In retrospect, Arthur Levitt, then SEC chairman, is recognised as the driving force behind the total ban on the provision of non-audit services by auditing firms, who after a multi-year effort and in midst of the Enron and WorldCom failures, he gathered political support for the enactment of this provision. *See, e.g.*, Romano, R., 'The Sarbanes-Oxley Act and the Making of Quack Corporate Governance' (2005) 114 Yale L J 1521, 1562-1564.

[66] On the grounds of a review of the findings of studies that examine the extent to which non audit services by the external auditor compromises audit quality, *id. at* 1565-1607, criticises the underlying rationale that was advanced for banning the practice. Overall, the findings do not support a positive correlation between non audit services and audit quality.

[67] Romano reviews the empirical literature on the composition of audit committees to conclude that the Sarbanes-Oxley Act proposition requiring audit committees to consist solely of independent directors is not supported that it will reduce the probability of financial statement wrongdoing. On the contrary, some data suggest that it might be more efficacious to have a committee with members with financial or accounting expertise rather than independent members. In this setting, Romano criticises the path that the Sarbanes-Oxley Act followed to mandate independence instead of expertise. *Id.* at 1537-1561.

controls and for disclosing to the audit committee any deficiencies or fraud instances.[68]

To continue with Section 402 (a), it prohibits corporations from arranging or extending credit to executive officers or directors. Such absolute prohibition of executive loans is new to corporate law America, to the extent that state codes vary with respect to the ease with which corporations can extend credit to executives, yet total forbid conflicts with the state law approach.[69]

Finally, the Sarbanes-Oxley Act includes provisions for whistleblowers[70] and legal counsel and attempts to decrease the conflicts between auditing and other services from auditors, thus addressing management/auditor capture issues.[71]

Responding to the problems with both auditors and analysts, the Sarbanes-Oxley Act sought to restore the independence of *'gatekeepers'* by

[68] Breach of this corporate responsibility can give rise to criminal penalties according to s. 906 (c) of the Sarbanes-Oxley Act: 'Corporate Responsibility for Financial Reports'. For a discussion on the dimension of corporate responsibility as a component of fiduciary duties. *See, e.g.,* Romano, R., 'The Sarbanes-Oxley Act and the Making of Quack Corporate Governance' (2005) 114 Yale L J 1521, 1616.

[69] *Id.* at 1538-1539. Accordingly, the Hellenic Law 2190/1920, as amended, by virtue of Article 23a (par. a and b) stipulates a similar absolute prohibition of extending credit or providing loans to executive officers, members of the Board and close relatives up to third grade (*See, e.g.,* Hellenic Law 2190/1920 *on Public Limited Liability Companies* (sociétés anonymes), Official Government Gazette A37, as codified - [hereinafter the Corporations Law]). Such prohibition can not be waived and has been confirmed by numerous judicial cases, such as for instance Case Decisions 452/2005 and 2881/2004.

[70] The Sarbanes-Oxley Act included a groundbreaking provision protecting employees, who blow the whistle on corporate fraud, *à la* Sherron Watkins of Enron or Cynthia Cooper of WorldCom. These whistle-blower provisions provide broader remedies for employees than do other whistle-blower protection laws, such as those protecting employees, who face retaliation for reporting environmental or health and safety offences. *See, e.g.,* Ebeling, A., 'Blowing the Sarbanes-Oxley Whistle' *Forbes.Com* (18 June 2003).

[71] The 'capture' problem arises when a monitor becomes too close to the managers of the firm it is supposed to be monitoring; therefore they risk losing their objectivity. *See, e.g.,* Macey, R. J., 'A Pox on Both Your Houses: Enron, Sarbanes-Oxley and the Debate Concerning the Relative Efficacy of Mandatory versus Enabling Rules' (2003) 81 Wash U L Q 329. 'Agent capture' is also revealed in the business relationship between Arthur Andersen and Enron, where the auditors were too close to the Enron corporation that it was easy for Enron to capture Arthur Andersen auditors to the point that they were, basically, working for Enron rather than Arthur Andersen. *See, e.g.,* Coffee, J. C., 'Why Didn't the Watchdogs Bark?' (2007) The Conference Board Review (an interview by A. J. Vogl).

various strategies. The importance of the Sarbanes-Oxley Act lies precisely in the creation of an entirely new structure for regulating accountants by eliminating the form of self-regulation that existed in the past and by creating new corporate governance structures.[72] The ultimate success of the Act is still to be seen, although there are empirical studies that do not fully support the underlying rationale for the enactment of the Act.[73] Certainly, the Sarbanes-Oxley Act needs further work and refinements to encapsulate specific dimensions of corporate governance problems and alleviate the compliance cost imposed on specific type of corporations, e.g. small firms.

It follows that the collapse of Enron and WorldCom, *inter alia*, have proven to be valuable wake-up calls with important reforms to take place, which were certainly needed for some time.[74] However, besides regulatory reforms, another important dimension of the magnitude of the American corporate scandals is marked by the recent Enron trial, which appears to bring a change in the rules of the game. The climax of the most notorious scandal in corporate America is the announcement of the verdict of the jury that found guilty the two former Enron CEOs.[75] Notably, the terms of the settlements and

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[72] *See, e.g.*, Sale, H. A., 'Gatekeepers, Disclosure and Issuer Choice' (2003) 81 Wash U L Q 403, 408. The federal regime had until then considered disclosure requirements rather than substantive corporate governance mandates, which were traditionally left to state corporate law and were not part of the federal securities regime. Importantly, the SOX altered the division of authority by providing explicit legislative directives for SEC regulation of what was previously perceived as the states' exclusive jurisdiction. *See, e.g.*, Romano, R., 'The Sarbanes-Oxley Act and the Making of Quack Corporate Governance' (2005) 114 Yale L J 1521, 1523.

[73] Such studies are reviewed by Romano, R., 'The Sarbanes-Oxley Act and the Making of Quack Corporate Governance' (2005) 114 Yale L J 1521.

[74] Several authors have argued that the US Congress should 'shoulder some of the blame' for the Enron mess, because of its repeated refusal to respond to attempts by SEC and others to improve accounting regulation. *See, e.g.*, Schroeder, M., and G. Hitt, 'Congress Fought Changes to Accounting Rules over Past Decade' *Wall Street Journal* (New York, 20 January 2002) A20.

[75] Former Enron CEO Jeffrey Skilling was sentenced to 24 years and four months in the harshest sentence yet in the case that arose from the energy trading giant's collapse. Accordingly, Andrew Fastow, Enron's former CFO, was sentenced to serve a 10-year prison term and help prosecutors in their investigation of other Enron executives. On 26 September

the charges were unusual to the extent that the directors involved were held personally liable, therefore they had to make some payments out of their own pockets and their personal assets were at stake. Although one can argue that such ruling is paradigmatic and exceptional, yet it is not unprecedented.[76] Hence, in such state of affairs, one has to reflect on the implications of Enron not only in terms of production of emergency regulation but also from the angle of application of corporate law.

On the other side of the Atlantic, in Europe, a number of initiatives to strengthen corporate governance arrangements were already in the pipeline before the revelations of the so-called 'European Enron', i.e. the Parmalat in Italy. Yet, the Parmalat affair crystallised the importance of intensive and timely implementation of the new corporate governance measures, especially in the fear that such corporate failure may have major spill over effect to the EU market as a whole.

Similarly, the failure of Parmalat, in Italy, shed light on the weaknesses in the Italian system of corporate governance. The Italian government, and the then Prime Minister, Silvio Berlusconi, promised at that time rapid and far-reaching reforms of Italy's financial regulatory system. The then Finance Minister, Giulio Tremonti, outlined proposals to create a super-agency to coordinate the government bodies that regulate banking, business and investing, and to give more power to regulators.[77]

2006, he received a lighter sentence of six years. *See, e.g.*, Pasha, S., 'Skilling Gets 24 Years: Ex-Enron CEO Sentenced for his Role in the Grand-Daddy of Corporate Frauds' *CNNMoney.com* (24 October 2006).

[76] On the prospect of personal liability for directors and its implications for the market of directors, *see, e.g.*, Harvard Law School, 'Symposium on Director Liability', John M. Olin Centre for Law, Economics and Business, (4 November 2005), Discussion Paper 547.

[77] *See, e.g.*, Delaney, S., 'Parmalat Spurs Call for Reform in Business. Italian Government Plans to Strengthen Oversight' *The Washington Post* (20 January 2002) E01.

Whereas many analysts have long argued that major reforms have been necessary and that accountability must be increased at every level (company administrators, auditors and the regulatory agencies) it was only after the revelation of the Parmalat scandal that the Italian political and regulatory authorities started seriously talking about vital corporate governance reforms and strategies to enhance the current corporate environment.

At EU level, the Parmalat case was of particular importance and has inspired an intense debate in the EU about the possible needs for further regulation in the area of company law and corporate governance. In this context, an important EU initiative in the area of company law and corporate governance was the Action Plan in the form of Communication.[78] The Action Plan was the Commission's response to the *Final Report on a Modern Regulatory Framework for Company Law in Europe* by the High Level Group of Company Law Experts, which was set up by the European Commission to prepare recommendations in this area.[79] In practice, the extended mandate of the Group focused on the issues of disclosure; the role of shareholders; on the Board of Directors; auditing practices; remuneration of directors; and corporate governance regulation in Europe.

In essence, the Action Plan, which is based on a comprehensive set of legislative and non-legislative measures, aims to be *'flexible in its application,*

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[78] *See, e.g.,* Commission Communication COM(2003)284final of 21 May 2003 on Modernising Company Law and Enhancing Corporate Governance in the European Union – A Plan to Move Forward (The Action Plan). As with many of the national law reforms, this EC initiative was the outcome of prior advice provided by a High Level Group of Company Law Experts, which had been set up prior to the Enron scandal, yet completed its report after the scandal's occurrence.

[79] *See, e.g.,* High Level Group of Company Law Experts, 'Final Report of the Group on Modern Regulatory Framework for Company Law in Europe' (2002) 4 November, Press Release (IP/02/1600); and European Commission, 'Company Law: Commission Creates High Level Group of Experts' (2001) 4 September, Press Release (IP/01/1237).

but firm on principles'. Briefly, it aims to: (a) strengthen shareholders' rights and protection for employees, creditors and the other third parties with which companies deal, while adopting company law and corporate governance rules appropriately for different categories of company; (b) foster the efficiency and competitiveness of business in EU, with special attention to some specific cross-border issues; and (c) contribute to rebuilding European investor confidence.

In the context of the realisation of the objectives envisaged in the Action Plan, the European Commission conducted four public consultations seeking to receive the views of interested parties with respect to issues of shareholders' rights;[80] the role of the independent, non-executive or supervisory director;[81] the modernisation of board structures, board responsibilities and improvement of dissemination of financial information;[82]

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[80] The European Commission launched on 16 September 2004 the first public consultation on facilitating the exercise of basic shareholders' rights in company's general meetings and solving problems in the cross border exercise of such rights, particularly voting rights. *See, e.g.*, European Commission, 'Corporate Governance: Commission Consults on Shareholders' Rights' (2004) 16 September, Press Release (IP/04/1107); and European Commission, DG Internal Market, 'Fostering an appropriate regime for shareholders' rights' Consultation Document of the Service of the Internal Market Directorate General (2004) 16 September. On 13 May 2005 the second public consultation took place. *See, e.g.*, European Commission, 'Corporate Governance: Commission Consults on Minimum Standards that Should Apply to Shareholders' Rights' (2005) 13 May, Press Release (IP/05/561). Following those consultations, on 5 January 2006, the European Commission published the Proposal for a Directive of the European Parliament and of the Council on the exercise of voting rights by shareholders of companies having their registered office in a Member State and whose shares are admitted to trading on a regulated market and amending Directive 2004/109/EC (COM(2005)685final), and on 11 July 2007 the Directive on Shareholders' Rights was adopted (*see, e.g.*, Council Directive (EC) 2007/36/EC of 11 July 2007 on the Exercise of Certain Rights of Shareholders in Listed Companies [2007] OJ L184/17).

[81] *See, e.g.*, Commission Recommendation COM(2005)162 final of 15 February 2005 on the role of non executive or supervisory directors of listed companies and on the committees of the (supervisory) board [2005] OJ L52/51. The European Commission launched on 5 May 2004 a consultation on the role of non-executive or supervisory directors, focusing in particular on those who may be considered as independent. The responses to this consultation were taken into account for the preparation of the Commission's Recommendation to Member States on this issue.

[82] *See, e.g.*, European Commission, 'Company Law: Consultation on Board Responsibilities and Improving Financial and Corporate Governance Information' (2004) 26 April, Press Release (IP/04/538). On 26 April 2004, the Services of the DG Internal Market launched an on-line consultation. In this setup, the Commission intended to put forward one proposal covering these three issues (namely, responsibility of board members for financial statements

and the remuneration of directors,[83] respectively. The outcome of most of the above consultations was either the adoption of recommendation or directive.

The aforementioned legislative initiatives were proposed and adopted after the revelation of the Parmalat affair, but prior to that scandal some other legislative initiatives were already in the pipeline. Basically, apart from the Financial Services Action Plan (FSAP),[84] the European Commission in order to address the failure of external auditors proposed a new legislative action with the publication of the Communication on *'Reinforcing Statutory Audit in the EU'*.[85] In addition, several EU Directives, namely the *'Transparency*

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and key non financial information; intra-group transparency; and disclosure about corporate governance practices), implying at the same time the need to amend the fourth and seventh Company Law Directives (known as the 'Accounting Directives'. *See, e.g.,* Fourth Council Directive (EEC) 1978/660 of 25 July 1978 based on Article 54(3)(g) of the Treaty on the annual accounts of certain types of companies, as last amended by Council Directive (EC) 2003/51 (OJ L178/16) [1978] OJ L222/11; and Seventh Council Directive (EEC) 1983/349 of 13 June 1983 based on Article 54(4)(g) of the Treaty on consolidated accounts, as last amended by Council Directive (EC) 2003/51 (OJ L178/16) [1983] OJ L211/31). For the proposal *see, e.g.,* European Commission, 'Proposal for a Directive of the European Parliament and of the Council, amending Council Directives 78/660/EEC and 83/349/EEC concerning the annual accounts of certain types of companies and consolidated accounts' (2004) 28 October. On 14 June 2006, the Council adopted the Directive on board responsibilities (*see, e.g.,* Directive 2006/46/EC of the European Parliament and of the Council of 14 June 2006 amending Council Directives 78/660/EEC on the annual accounts of certain types of companies, 83/349/EEC on consolidated accounts, 86/635/EEC on the annual accounts and consolidated accounts of banks and other financial institutions and 91/674/EEC on the annual accounts and consolidated accounts of insurance undertakings [2006] OJ L224/1).

[83] *See, e.g.,* European Commission, 'Corporate Governance: Commission Consults on Directors' Remuneration' (2004) 23 February, Press Release (IP/04/252). On 23 February 2004, the European Commission launched a consultation on fostering an appropriate regime for directors' remuneration. The outcome of the public consultation was the Commission Recommendation of 6 October 2004 on fostering an appropriate regime for the remuneration of listed company directors. Also, *see, e.g.,* European Commission, 'Draft Commission Recommendation on fostering an appropriate regime for the remuneration of directors of listed companies' (2004) 6 October; and European Commission, 'Director's Pay-Commission Sets Out Guidance on Disclosure and Shareholder Control' (2004) 6 October, Press Release (IP/04/1183).

[84] *See, e.g.,* Commission Communication COM(1999)232final of 11 May 1999 on Implementing the Framework for Financial Markets: Action Plan.

[85] *See, e.g.,* Commission Communication COM(2003)286final of 21 May 2003 on Reinforcing the Statutory Audit in the EU [2003] OJ C236/3. The main legislative document on statutory audits is the Eight Council Directive (EEC) 1984/253 of 10 April 1984 based on Article 54(3)(g) of the Treaty on the approval of persons responsible for carrying out the statutory audits of accounting documents [1984] OJ L126/20. Additionally, the statutory audits legal framework is supplemented by Commission Recommendation 2002/590/EC of 16 May 2002 on Statutory Auditors' Independence in the EU: a Set of Fundamental Principles

Directive,[86] the *'Market Abuse Directive'*[87] and the *'Prospectus Directive'*,[88] have already been adopted or they are in the process of the final implementation by EU Member States and are expected to provide solutions with regard to financial accounting and disclosure of information. In more precise terms, the Market Abuse Directive addresses, *inter alia*, issues of market manipulation and insider dealing, referring also to the role of financial and reputational intermediaries to work as gatekeepers in a system of external checks and balances on corporate governance.

Furthermore, the protection of investors and the maintenance of confidence in financial markets, as an important aspect of the completion of the internal market, are achieved by the Council Regulation on the application of International Accounting Standards.[89] The application of IAS by January 1, 2005 is important for the competitiveness of Community capital markets to achieve convergence of the standards used in Europe for preparing financial statements, with international accounting standards that can be used globally, for cross-border transactions or listing anywhere in the world.[90]

(OJ L191/22); and Commission Recommendation 2001/256/EC of 15 November 2000 on Quality Assurance for the Statutory Audit in the EU: Minimum Requirements (OJ L91/91).

[86] *See, e.g.*, Council Directive (EC) 2004/109 of 15 December 2004 on the harmonisation of transparency requirements in relation to information about issuers whose securities are admitted to trading on a regulated market and amending Council Directive (EC) 2001/34 [2004] OJ L390/38 (the Transparency Directive).

[87] *See, e.g.*, Council Directive (EC) 2003/6 of 28 January 2003 on insider dealing and market manipulation (market abuse) [2003] OJ L96/16 (the Market Abuse Directive).

[88] *See, e.g.*, Council Directive (EC) 2003/71 of 4 November 2003 on the prospectus to be published when securities are offered to the public or admitted to trading and amending Council Directive (EC) 2001/34 [2003] OJ L345/64 (the Prospectus Directive).

[89] *See, e.g.*, Council Regulation (EC) 1606/2002 of 19 July 2002 on the application of International Accounting Standards (IAS) [2002] OJ L243/1 (the IAS Regulation). The IAS is adopted by the London-based International Accounting Standards Board (IASB), with the participation of the European Commission. These common rules will be known in the future as International Financial Reporting Standards (IFRS).

[90] *See, e.g.*, Council Regulation (EC) 1606/2002 of 19 July 2002 on the application of International Accounting Standards (IAS) [2002] OJ L243/1 (the IAS Regulation).

Finally, the initiative of the Katiforis Report[91] that deals with the role of credit rating agencies in the EU context is recognised as an important step at EU level to enhance the company law and corporate governance arrangements.

From the angle of the OECD initiatives, it is important to note that since the OECD Principles of Corporate Governance were first published in 1999, a number of corporate scandals have undermined the confidence of investors in financial markets and company boards.[92] Therefore, in 2002, the OECD governments called for a review of the Principles to take account of these developments. On 22 April 2004, OECD governments approved a revised version of the OECD Principles of Corporate Governance adding a series of new recommendations and modifying others.[93] The revised OECD Principles are designed to assist policy makers in both developed and emerging markets in improving corporate governance in their jurisdictions, as a vital step in rebuilding public trust in companies and financial markets.

In brief, the new OECD Principles call for a stronger role for shareholders in a number of important areas, including executive remuneration and the appointment of board members; call on companies to make sure that they have mechanisms to address possible conflicts of interest; to recognise and safeguard the rights of stakeholders and build a framework in which internal complaints can be heard, with adequate protection for individual whistleblowers. Furthermore, they stress the responsibilities of auditors to shareholders and the need for institutional investors acting in a

[91] *See, e.g.*, Committee on Economic and Monetary Affairs, 'Report on the Role and Methods of Rating Agencies' (2004) Rapporteur Giorgios Katiforis, 29 January, (2003/2081(INI)), [A5-0040/2004].
[92] *See, e.g.*, OECD, (1999), 'OECD Principles of Corporate Governance'.
[93] *See, e.g.*, OECD, (2004), 'OECD Principles of Corporate Governance'.

fiduciary capacity, such as pension funds and collective investment schemes to be transparent and open about how they exercise their ownership rights.[94] Additionally, they call on company boards to be truly accountable to shareholders and to take ultimate responsibility for their firm's adherence to a high standard of corporate behaviour and ethics.[95] For board members, this means fostering the best interests of the company and the shareholders who have invested their money in the company, which they oversee. But it also involves establishing productive relationships with other stakeholders such as employees and balancing their interests with others.[96]

Recent history has shown that boards in some cases have failed to play this role, condoning remuneration packages that have no true link to performance, for example, and approving excessively ambitious expansion projects that have undermined a company's stability. To guard against such practices, the OECD Principles call for directors 'capable of exercising independent judgement' and for boards able to 'exercise objective independent judgement on corporate affairs', independent, in particular from management and in many cases from controlling shareholders and others in a position to control the company.[97]

The OECD Principles also address the issues relating to transparency and disclosure, ranging from the internal preparation of financial reports and internal controls through to the role of the board in approving the disclosure, the accounting standards being used and the integrity of the external audit

[94] *See, e.g.*, OECD, (2004), 'OECD Principles of Corporate Governance', at 3 and 37.
[95] *Id.* at 58.
[96] *Id.* at 60.
[97] *See, e.g.*, OECD, 'Improving Business Behaviour: Why We Need Corporate Governance?' (Speech on the OECD) 25 May 2004.

process.[98] Notably, a number of countries have introduced public oversight of the setting of accounting and audit standards, while a growing number of countries restrict the non-audit services that auditors can offer their clients, so as to avoid creating business interests that might undermine the independence of the audit process. These are areas covered by recommendations in the revised OECD Principles.

Finally, the OECD Principles emphasise the need for effective regulatory systems ensuring that the potential for damaging conflicts of interest remains limited and that there is a level playing field among the major participants in corporate governance, for example, through protection of minority shareholders.[99] Effective implementation and enforcement require that laws and regulations are designed in such a way so as to make them possible to implement and enforce in an efficient and credible fashion. Supervisory, regulatory and enforcement authorities should have the power, integrity, and resources to act professionally and objectively.[100]

By and large, by agreeing on these Principles, the OECD governments have set the broad foundations for high standards of corporate governance. The legislation needed to enforce those standards is the responsibility of individual governments, and in enacting it, governments, and policy makers need to find a balance between rules and regulations on one hand and flexibility on the other. In the future, the governments of OECD countries are committed to maintaining an open dialogue with all the parties involved so that everyone can learn and benefit from the shared experiences of putting

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[98] *See, e.g.*, OECD, 'Improving Business Behaviour: Why We Need Corporate Governance?' (Speech on the OECD) 25 May 2004.
[99] *Id.*
[100] *Id.*.

these Principles into practice. This is vital to ensuring that the OECD Principles remain relevant and effective, evolving as new issues arise.[101]

The analysis thus far has demonstrated that appropriate corporate governance structures are necessary conditions, *inter alia*, for corporations to stay afloat and remain profitable. This was achieved by not only outlining its positive impact on business development and the protection of shareholders but also by highlighting the magnitude of recent corporate scandals. Although it would be a groundless generalization to claim that corporate governance weaknesses were alone the critical reasons for those failures, it is rather supported that such weaknesses seem to have dramatically deepened the scope of those failures. The importance of those failures, which as analysed above, was due to, *inter alia*, corporate governance weaknesses, is mainly raised by the prompt regulatory reforms that followed. Immediately after those collapses, regulators' concerns were centred on avoiding similar failures in the future, aiming to create a stronger corporate governance framework that would ensure greater business development and better shareholders' protection. The call for reforms was not only evidenced by the regulators of the directly affected countries, *vis-à-vis* the USA and EU, but importantly also by the OECD governments. The revised OECD Corporate Governance Principles reflect a milestone development in the corporate governance domain, since they are the international benchmarks. The Principles are now better able to capture the modern aspects of corporate governance weaknesses and problems, therefore further ensuring that corporations and shareholders

[101] *See, e.g.*, OECD, 'Improving Business Behaviour: Why We Need Corporate Governance?' (Speech on the OECD) 25 May 2004.

are better off with the application of more modernized corporate governance principles.

3. DISCUSSING THE IMPORTANCE OF CORPORATE GOVERNANCE IN A SPECIFIC CONTEXT: FAMILY FIRMS AND GREECE

Having thus far established, by using both the positive and the negative analysis, the increased significance of strong corporate governance, for ensuring business development and protecting shareholders' rights, the focus of the analysis now shifts to discuss the importance of corporate governance in the specific context of the Greek corporate affairs with special attention to family firms. Therefore, an important question is addressed. Is corporate governance of importance also in the case of the operation of family firms? In the analysis that follows the main argument stressed is that likewise in the more specific context of Greece and in the case of family controlled firms, as the most dominant type of business formation, strong and appropriate corporate governance arrangements are equally beneficial.

Although, in the context of the positive and the negative analysis the common assumption taken on examining the importance of good corporate governance was the reliance on external finance, as a basic parameter for corporate governance considerations, *vis-à-vis* principal-agent concerns, yet, even if corporations do not rely primarily on foreign sources of capital or external financing, such as in the case of family controlled firms, adherence to good corporate governance practices is equally important. Even in family firms' affairs, there are agency concerns, though on a different perspective. In this setup, the importance of corporate governance is directed on strengthening the confidence of domestic investors; reducing the cost of capital; and ultimately inducing more stable sources of financing through bank loans.[102]

Furthermore, one could well argue that Greek corporations, as family firms that do not heavily rely on external finance would not be that much interested in strong corporate governance structures. However, this is not the case. At this point of the analysis, the issue is tackled from the corporations' succession point of view, in the sense that family firms are interested in continuing their profitable operations for many more generations. In doing so at some point of the firm's evolution, external capital is to be needed,[103] which in order to secure a decisive condition for external financiers will be the existence of corporate governance structures, as shown above. Hence, the concept of the corporate governance becomes relevant for family firms as well.

Complementary to the theoretical analysis on those specific elements that advance good corporate governance as an important determinant for family firms, a testament to its added value is primarily provided from two recent family firms' failure experiences: Adelphia and Parmalat.

In 2002, Adelphia was the sixth largest cable television company in the USA founded by John Rigas.[104] On 25 June 2002, the company filed for bankruptcy saying that it could not meet the $7 billion in outstanding loans. A

[102] *See, e.g.,* OECD, (2004), 'OECD Principles of Corporate Governance'.
[103] Such external capital can be either in the form of a bank loan or by listing their shares in the Athens Stock Exchange.
[104] *See, e.g.,* SEC News Digest, 'SEC and US Attorney Settle Massive Financial Fraud Case against Adelphia and Rigas Family for $715 Million', Commission Announcements, Issue 2005-79, 26 April 2005.

month after the bankruptcy five executives (including three members of the Rigas family) were arrested charged with looting.[105] The indictment charged that the Rigas family used billions of dollars in Adelphia's funds and assets for their own benefit.[106] Such uses of Adelphia's funds and assets by the Rigas family were not presented to or authorised by the Adelphia's Board of Directors and were not disclosed to the non family members of the board or to the public.

Although Adelphia was a publicly held company, its management was almost entirely controlled by the founding Rigas family. In practice, the family controlled the board with Rigas, his sons and his son-in-law holding five of the nine seats of the board. The other four were held by friends and business associates, who knew that if they rocked the boat they would be replaced.[107] As the Fortune magazine quoted 'Decisions were made at the dinner table rather than in a boardroom'.[108]

Similarly, the recent collapse of the Parmalat in Italy is another bold revelation of the importance of good corporate governance mechanisms, and the absence thereof, in family firms.[109] Parmalat represented a close-knit family model, which appears to have kept its financial problems a secret,

[105] *See, e.g.,* Markon, J., and R. Frank, 'Adelphia Officials Are Arrested, Charged with Massive Fraud' *Wall Street Journal* (25 July 2002).

[106] Among other things, the defendants allegedly caused Adelphia to pay more than $250 million in connection with personal loans to the Rigas family. From 1999 through April 2002, members of the Rigas family allegedly took unauthorised and undisclosed cash advances from Adelphia, totalling more than $50 million. *See, e.g.,* Monks, R. A. G., and N. Minow, *Corporate Governance* (3rd edition, Blackwell Publishing Ltd 2004), at 489-493.

[107] *See, e.g.,* Monks, R. A. G., and N. Minow, *Corporate Governance* (3rd edition, Blackwell Publishing Ltd 2004), at 489-493.

[108] *See, e.g.,* Devin, L., 'The Adelphia Story: the Sixth Largest Cable Company Might as Well Have Been Called John Rigas & Sons. It's Rise and Fall Was a Small Town Saga of Epic Dimensions' *Fortune Magazine* (12 August 2002).

[109] Parmalat was like most Italian firms launched as a family business founded by Calisto Tanzi. The Tanzi family owned 51% of the shares and the company's board was made up mainly of family and friends (such as Tanzi's brother; his son and his niece), who all held senior positions. *See, e.g.,* Arie, S., 'Time for a Break in the Family Circle' *The Guardian Unlimited* (15 January 2004).

since its family-dominated board waived its oversight responsibilities to the detriment of the company and its stakeholders.[110]

Therefore, good corporate governance arrangements seem to be needed in family firms as in other types of corporations in order to ensure, *inter alia*, transparency of transactions and the presence of independent board members. Such need is underlined by the closely held ownership structures; the leadership; and the evolutionary dynamics, as the distinct features of family owned firms. More particularly, good corporate governance arrangements address three organisational requirements, which need to be taken into account if family firms are to manage successfully the consequences of growth.[111] They need to be able to (i) recruit and retain the very best people for the business;[112] (ii) develop a culture of trust and transparency;[113] and (iii) define logical and efficient organisational structures.[114] The added complexity of the family factor puts extra challenges on the company's corporate governance and makes the latter a crucial element for addressing those challenges and, likewise, creating a more formal pattern of organisation.[115]

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[110] *See, e.g.*, Galloni, A., and Y. Trofimov, 'Behind Parmalat Chief's Rise: Ties to Italian Power Structure' *Wall Street Journal* (8 March 2004).
[111] *See, e.g.*, Cadbury Sir, A., 'Family Firms and their Governance: Creating tomorrow's Company from Today's' (2000) Egon Zehnder International, at 13.
[112] The family firm's policy on recruitment and promotion is crucial to its continued success. The future of a family firm depends on its ability to pick and promote the right members of the family and equally to provide attractive opportunities to managers from outside the family. *Id.* at 13-14.
[113] For instance, for both family and non-family members, it is essential that rewards, whether financial or non-financial, are distributed fairly and transparently and accounted for in a clear and precise way. *Id.* at 18.
[114] If family firms are to manage their growth successfully, they have to adapt their structure to cope with it. When the firm becomes larger, a more formal of organisation is required, followed by clearly defined roles and responsibilities. *Id.* at 20.
[115] *See, e.g.*, Van de Berghe, L. A. A., and S. Carchon (2002) 'Corporate Governance Practices in Flemish Family Businesses' 10 (3) CG 225, 242.

Particularly with regard to family firms, the concern of succession is typically a problematic issue. Although failures of family firms to make the transition to the second or third generation are often accounted for by the founder's / owner's personality or on the problematic relationship with the parents, very often the lack of a concrete succession plan, as part of a corporate governance framework, can be also a decisive element in a firm's financial and operational sustainability.[116] Basically, as a business grows, it becomes increasingly complex, creating its own demands for a more formal organizational structure, *vis-à-vis* corporate governance arrangements. Therefore, it appears that good corporate governance can answer both succession issues and change in business scale plans.[117]

Furthermore, in terms of reliance on external finance, even though traditional privately held family firms may not heavily rely on financial markets for capital, (which might to a certain extent excuse their poor corporate governance mechanisms) there are situations where external capital is important for the continuation of their operations. Although, as aforementioned, typically the principal capital of family firms is a large percentage of the available wealth of the family, in the wake of global competitiveness forces, family firms are confronted with new challenges to stay competitive. In doing so, they have to expand their operations and the range of services offered, which inevitably entails financing concerns. In this setup, financial markets become fertile ground for those families that wish to

[116] Companies with strong corporate governance system presented higher standards of activism among the top companies. *See, e.g.,* London Business School, *'Corporate Governance for Corporate Sustainability: The Greek Reality, 1945-2000'* (in Greek) (2003) Greek Alumni Association (Kantor: Genesis Pharma SA), at 5.

[117] *See, e.g.,* Van de Berghe, L. A. A., and S. Carchon (2002) 'Corporate Governance Practices in Flemish Family Businesses' 10 (3) CG 225, 243; and Ward, J.L., 'Governing Family Business' (2005) 10 (1) *Economic Perspectives* 38, 41.

sacrifice family control and presence in the board for competitiveness, growth and expansion. Yet, investors, as revealed by the McKinsey survey,[118] are not willing to be exposed to risks, mainly deriving from poor monitoring mechanisms and on the contrary are willing to pay a premium for good corporate governance institutions. All the above justify the deposition that sooner or later, corporate governance concerns will be important agenda items in the family board meetings.

When it comes to the Greek family firms, the above discussion does not change substantially. Greek family firms face similar concerns and corporate governance needs are to be up in their agenda. Succession concerns and profitability issues are at the core of Greek family firms' operation plans. As demonstrated by the recent survey undertaken by PricewaterhouseCoopers (PwC) in 2006, the issues of concerns of family firms, such as succession, expansion, development, financing, strategic planning, could be well dealt if management focused on establishing appropriate corporate governance arrangements.[119]

Overall the discussion on corporate governance arrangements in Greece is equally important. More particularly, according to the Principles of Corporate Governance in Greece,[120] the success of the Greek economy depends on good performance and efficient growth of the Greek companies. The achievement and preservation of satisfactory corporate and national economy efficiency levels in Greece requires the reduction in the cost of equity capital. If Greece wishes to remain the centre of decision-making in the

[118] *See, e.g.,* Campos, C., R. Newell and G. Wilson, 'Corporate Governance Develops in Emerging Markets', (2002) McKinsey on Finance (Winter) 15-18.
[119] *See, e.g.,* PricewaterhouseCoopers, '*Survey on Family Firms*' (in Greek) (2006).
[120] *See, e.g.,* Committee on Corporate Governance in Greece (under the coordination of the HCMC) 'Principles on Corporate Governance in Greece: Recommendations for its Competitive Transformation' (The Mertzanis Report) 1999 Athens, Greece.

Balkan region with the ultimate mandate of sustaining its long-term economic growth, it should proceed with the undertaking of strong initiatives for its competitive restructuring of the regulatory framework conditioning the operation of financial markets. The adoption of a transparent and internationally recognised business regulation framework is imperative so as to enable the Greek corporate market to sustain its competitiveness.[121]

Especially, in light of Greece's membership to the EU, since 1981, failure to develop and adopt a robust and strong institutional and regulatory framework may place Greece at a competitive disadvantage, since corporations might choose to move away from Greece and rather develop their business activities in countries that offer more properly supervised and business-oriented environments. Additionally, such failure might dramatically damage the ability to attract more foreign investments.

Against these considerations, the corporate governance debate is paramount to the Greek corporate market. The focus is on the design and effective implementation of appropriate mechanisms for the management, monitoring, and control of operation of mainly family firms. The particular structure of ownership of Greek corporations, characterised by high levels of concentration and the dominance of family firms further confirms the importance of good corporate governance. As above analysed, such good corporate governance arrangements are vital for the succession and survival of family firms.

The moderated agency problems of family firms (*vis-à-vis* Greek corporations), largely deviating from the dominant Anglo-Saxon ones, does

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[121] *See, e.g.*, Committee on Corporate Governance in Greece (under the coordination of the HCMC) 'Principles on Corporate Governance in Greece: Recommendations for its Competitive Transformation' (The Mertzanis Report) 1999 Athens, Greece.

not erase the importance of a good corporate governance policy of such firms. On the contrary, as aforementioned, the use of Initial Public Offerings (IPO's), as a means for raising external finance and for family-owned firms to go public, brings good corporate governance to the fore. As the business grows and markets evolve, finding sufficient managerial experience within the family becomes harder, therefore management succession plans form part of a good corporate governance policy. Hence, the establishment of a modern corporate governance framework is considered as an essential prerequisite for the competitive transformation of the Greek capital market and economy.

4. CRITICAL FACTORS UNDERMINING CORPORATE GOVERNANCE EFFICIENCIES

Introduction

As aforementioned, the existence of appropriate corporate governance standards is linked with positive effects for the operation of public companies and significant added value for the profitable continuation of activities of family firms. Yet, it is important to stress that a less than appropriate introduction and implementation of good corporate governance rules is not sufficient to bring integrity to both types of business organisations. Rather, in order for public companies to reap the full range of benefits of good corporate governance norms, it is of utmost importance that their directors and senior management have rules that are capable of being appropriately implemented to serve economically efficient ends as well as the achievement of certain special purposes. Similarly, directors and senior management of family firms are called to apply the standard set of corporate governance rules, provided that it follows the pace of the rapid development of stock exchanges and corporate markets in Europe and worldwide and the strengthening of the role and importance of shareholders. All these factors demand continuous review and updating of corporate governance rules.

Notwithstanding that it is very positive that policy makers are now more aware of the contribution that good corporate governance makes *-inter alia-* to business development and the protection of shareholders' rights, this chapter concludes with an analysis of a number of conditions that have significantly affected the overall effectiveness and success of corporate governance framework. More particularly, the aim of this analysis is to highlight a number of conditions that were only recently understood as decisive corporate governance parameters.

Unarguably, public companies now better understand the added value of good corporate governance to their competitiveness; investors, (especially collective investment institutions and pension funds acting in a fiduciary capacity) realise their central role in ensuring good corporate governance practices, thereby boosting the value of their investments.[122] However, even if good corporate governance achieves positive efficiencies and more actors pay attention to applying corporate governance principles, these are hardly a

[122] Although it exceeds the scope of the present focus, it is important to note that the duty and power of institutional investors to promote good corporate governance is been blocked by specific barriers, as these have been addressed by a recent speech by Ira Millstein in the ICGN 2006 Annual Conference. Briefly, Millstein stated that 'institutional investors, under any corporate governance system, are not choosing directors very well due to various matters, which tip the scale in favour of management interest. Institutional investors should have greater impact on the selection and dismissal of directors. Instead, in too many cases, they abjure the hard work of using their own heads and judgment in individual situations'. Millstein concludes that it is important to identify 'the degree to which the system causes institutional investors to leave the scale tipped in favour of management. To restore balance means dealing with all the vested interests at both ends of the scales and it may well mean serious changes in the governance of some of institutional investors'. *See, e.g.*, Millstein, I. M., 'The Board – Governing Beyond Where the Law Ends', Washington DC, (5 July 2006) at 5-10.

guarantee for business development and the protection of shareholders' rights if not coupled with a number of decisive conditions. For the achievement of those objectives, it is important that such a corporate culture is in place, so as to ensure the strong role of gatekeepers and that an effective whistle-blowing mechanism is established. These conditions have been marked as important for any corporate governance framework amid the recent corporate scandals in the USA and Europe, as analysed above.

More particularly, the above review of the corporate scandals in the USA and Europe that were followed by significant regulatory reforms explains that corporate governance matters, since weak corporate governance arrangements can have adverse effects on the sound operation and business development of corporations. Since then, corporate governance is properly understood as an element of managing risk -risk for investors and shareholders, whose interests may not be protected by ineffectual or corrupt managers and directors, and also risk for employees, communities, lenders, suppliers and customers'.[123]

Furthermore, as companies play a pivotal role in economies, good corporate governance is important for the economy at large. A legal manifestation of that is the prompt corrective action that was initiated after the revelations of the aforementioned corporate failures, as analysed. Corporate America and Europe were dramatically concerned by those revelations and in order to avert potential corporate failures,[124] they introduced improved

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[123] *See, e.g.,* Monks, R. A. G., and N. Minow, *Corporate Governance* (3rd edn, Blackwell Publishing Ltd 2004).
[124] *See, e.g.,* Niskanen, W. A., 'A Preliminary Perspective on the Major Policy Lessons from the Collapse of Enron' (2002) Cato Institute.

regulations and enhanced the existing legal framework, aiming to create a robust corporate environment.

More particularly, a new era of a genuinely democratised corporate governance process evolves with investors' attention to be directed, *inter alia*, towards independence in the audit process, the introduction of stringent compliance and monitoring standards in the company, the development of enhanced rules with regard to disclosure and the imposition of penalties in the event of non-compliance.

Furthermore, those collapses and the legal reforms that followed revealed not only the importance of good corporate governance but also raised the increasing need and priority to restore confidence in the gatekeeping professions and promote good ethical governance. The review of those wrongdoings demonstrated conduct that severely undermined confidence in the democracy of companies and the transparency expected from good ethical governance.[125] Therefore, in the context of those scandals, the detrimental consequences of weak internal auditing structures, financial reporting fraud and overall inadequate internal control systems were revealed by the demise of the corporations concerned.

Taking into account those critical elements, the focus now shifts to those factors that seem to have threatened the realisation of good corporate governance and the achievement of its dual scope (i.e. business development and the protection of shareholders' rights). In this setup, the discussion is centred on the existence of a corporate culture focusing on setting professional corporate values and targets and ensuring a strong voice for gatekeepers as a

[125] *See, e.g.*, Kirkbride, J., and S. Letza, 'Corporate Governance and Gatekeeper Liability: the Lessons from Public Authorities' (2003) 11 (3) CG 262, 263.

means of checks and balances that is coupled with effective whistle-blowing mechanisms.

Understanding the Gatekeeping Rationale upon Which the Gatekeepers' Role Rests

Significantly, whereas Enron's failure was primarily perceived as an unprecedented accounting scandal, it is argued that Enron is more a demonstration of gatekeeper failure than just simply an accounting fraud and embezzlement.[126] In other words, gatekeepers (as the reputational intermediaries responsible for confirming the prudent and transparent operation of the organization) let the market down, failing in their monitoring role. In practice, as the independence and objectivity of gatekeepers is eroded, externalities are likely to follow, namely, the cost of capital may rise slightly; the market efficiency should suffer; and the corporate governance will increasingly be distorted by inaccurate informational inputs. Therefore, corporate governance depends upon gatekeepers to protect the interests of investors by monitoring the behaviour of corporate insiders and by reporting the financial results of corporate performance in an accurate and unbiased fashion that permits objective valuation of the firm.[127] Additionally, American corporate directors depend upon their gatekeepers to a certain point that even a strongly competent board of directors is a prisoner of its gatekeepers.[128]

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[126] *See, e.g.,* Coffee Jr., J. C., 'Understanding Enron: It's about the Gatekeepers, Stupid' (2002) 57 Bus Law 1403, 1405.
[127] *Id.* at 1406.
[128] It is important to distinguish the case of corporate directors in Europe, since it is substantially different given the fact that ownership is more concentrated, contrary to the dispersed ownership of most US corporations, therefore the controlling shareholder in most cases has sufficient information about the company and its management. *See, e.g.,* Coffee, J. C., 'Why Didn't the Watchdogs Bark?' (2007) The Conference Board Review (an interview

It follows that addressing the question *'why did gatekeepers let management engage in fraud'* is critical in order to unravel, *inter alia*, the Enron debacle[129] and capture more on their role. To that end, gatekeepers' scope of liability, duties, and importance of their profession is discussed upon which the later analysis takes place. A cross examination of the role of gatekeepers in theory and in practice within the context of the corporate scandals reveals in the most prominent way their failing role.

To start with, the gatekeepers' role and its theoretical underpinnings can be best understood within the context of Kraakman's work that touches upon, for the first time, the issue of gatekeepers' liability.[130] In more precise terms, the author describes this notion as 'the attempts to force a portion of the enforcement burden onto firm participants, who are not themselves the initiators of corporate delicts'. For instance, in some firms, sometimes top managers-executives choose to gamble personal liability against the returns of bribery, price fixing or even third party fraud. These executives may simply be risk lovers or they may simply chance upon particularly illegal opportunities. But whatever the circumstances and motivation, it is certain that they do not gamble their careers and personal freedom expecting to be caught. Evidently, the problem rests both on the lack of adequate sanctions and the inefficient means of deterrence and detection, with emphasis on the

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by A. J. Vogl), at 1. The latter state of affairs can be to a larger extent found in the case of family firms, where the owner usually is member of the family board (and can be argued that gatekeepers have limited role to play).

[129] *See, e.g.*, Coffee, J. C., 'Why Didn't the Watchdogs Bark?' (2007) The Conference Board Review (an interview by A. J. Vogl), at 1.

[130] *See, e.g.*, Kraakman, R., 'Corporate Liability, Strategies and Costs of Legal Controls' (1984) 93 Yale L J 857.

later. Precisely, this deficiency is termed by Kraakman 'enforcement insufficiency'.[131]

It was this 'enforcement insufficiency' that led Kraakman to put forward the so-called *gatekeepers approach* as an alternative strategy to deal with this deficiency. The gatekeepers approach is a third party enforcement strategy that relies on the fact that it may be easier to deter a third party, who has less to gain than an entrepreneur, who has a significant stake in a questionable transaction.[132] Hence, there is a possibility that civil or criminal liability can induce firm participants *outside* the circle of controlling managers to discover and prevent offences. These outsiders are potentially gatekeepers.

Interestingly, the liability is imposed on an entirely new class of innocent gatekeepers (along with, of course, controlling managers) to reduce enforcement costs, the frequency of offences or even both. In other words, the gatekeepers are there because managers and the board of directors need to be checked.[133] Additionally, true gatekeeper liability is designed to enlist the support of outside participants in the firm when controlling managers commit offences, i.e. when the firm's internal monitors and checks have failed.

Inherently, gatekeepers are reputational intermediaries, who provide verification, certification services to investors and they assess the disclosures that they receive.[134] Corporations have hired these independent professionals

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[131] *See, e.g.*, Kraakman, R., 'Corporate Liability, Strategies and Costs of Legal Controls' (1984) 93 Yale L J 857, 858 and 867.

[132] *See, e.g.*, Coffee Jr., J. C., 'The Acquiescent Gatekeeper: Reputational Intermediaries, Auditor Independence and the Governance of Accounting' (2001) Centre of Law and Economic Studies, Columbia Law School, Working Paper 191.

[133] *See, e.g.*, Roe, M. J., 'The Inevitable Instability of American Corporate Governance' in J. W. Lorsch, L. Berlowitz and A. Zelleke (eds.), *Restoring Trust in American Business* (MIT Press 2005), at 9-33.

[134] *See, e.g.*, Coffee Jr., J. C., 'The Acquiescent Gatekeeper: Reputational Intermediaries, Auditor Independence and the Governance of Accounting' (2001) Centre of Law and Economic Studies, Columbia Law School, Working Paper 191. Gilson and Kraakman were

to add credibility to financial statements that corporate managers prepare, to reduce financial misstatement risk for investors, and to certify that financial statements are fairly presented in all material respects.[135] Specifically, these professionals are: (a) the auditor, who has a responsibility to limit some types of corporate misconduct risk by searching for possible financial statement fraud on the part of management and for extreme self-serving biases in the corporations' accounting choices and by disclosing known material illegal acts by the corporation;[136] (b) the debt-rating agency that evaluates the issuer's creditworthiness; (c) the securities analyst, who communicates an assessment of the corporation's competitiveness or earnings prospects; (d) the investment banker, who furnishes its fairness opinion as to the pricing of a merger[137]; (e) the securities lawyer for the issuer, who delivers an opinion to the underwriters that all material information of which the lawyer is aware concerning the issuer has been disclosed properly and writes a report that raises questions about the company's performance;[138] and (f) the press (*vis-à-*

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probably the first to employ the concept, without then naming it, when they described underwriters as 'reputational intermediaries'. *See, e.g.,* Gilson, R. J., and R. H. Kraakman, 'The Mechanisms of Market Efficiency' (1984) 70 Va L Rev 549.

[135] *See, e.g.,* Kinney Jr., W. R., 'The Auditor as Gatekeeper: a Perilous Expectations Gap' in J. W. Lorsch, L. Berlowitz and A. Zelleke (eds.), *Restoring Trust in American Business* (MIT Press 2005), at 99-107.

[136] Kinney's analysis touches upon three fundamental categories of risks that auditors are expected to tackle: (i) financial misstatement risk; (ii) corporate business risk; and (iii) corporate misconduct risk. *Id.*

[137] For instance, in the case of a public offering although sometimes the company is not widely-known, yet the fact that a top-tier investment company is underwriting it, amounts to the fact that the company is certified by the top-tier investment company and the latter has investigated the company and conducted due diligence on it, found it to be sound. *See, e.g.,* Coffee, J. C., 'Why Didn't the Watchdogs Bark?' (2007) The Conference Board Review (an interview by A. J. Vogl), at 1.

[138] There is an open debate on whether attorneys can be potential gatekeepers. Sceptics of any gatekeeper role for attorneys have long argued that such a role (1) conflicts with the traditional obligations of loyalty that attorneys owe their clients, and (2) will chill attorney-client communications. *See, e.g.,* Coffee Jr., J. C., 'The Attorney as Gatekeeper: An Agenda for the SEC' (2003) 103 Colum L Rev 1293, 1293.

vis business journalism) that has an acknowledged responsibility to protect the public interest by reviewing and disclosing corporate misconduct.[139]

By and large, gatekeepers can be drafted from among the many outsiders, who supply specialised expertise to the managers of corporations and facilitate their relations with constituencies outside the firm. Despite their disparate role, it is easy to see why the aforementioned professionals are likely targets for a gatekeeper liability strategy. Each has or might have low cost access to information about wrongdoing within the company. Contractually or informally, each already performs a private monitoring service on behalf of the capital markets. But most importantly, each is an outsider with a career and assets beyond the firm, namely each is an independent professional. At the very least, each of these potential gatekeepers face incentives that differ systematically from those of inside managers; in the usual case, they are likely to have less to gain and more to lose from such wrongdoing than inside managers.[140] Hence, theoretically, the existence of the gatekeeper offers an effective deterrence strategy.

On the theory that the gatekeeper will receive little, if anything, from corporate involvement in crime or misconduct, it may be assumed that they can be deterred more easily than the corporation or its managers, who may profit handsomely from crime and wrongdoing. Indeed, gatekeepers' liability can jeopardize not only the personal interests of individual lawyers and accountants, but also the larger interests and reputations of their respective firms or even their entire professions. In fact, gatekeepers' relative credibility

[139] *See, e.g.,* Overholser, G., 'Journalists and the Corporate Scandals: What Happened to the Watchdog?' in J. W. Lorsch, L. Berlowitz and A. Zelleke (eds.), *Restoring Trust in American Business* (MIT Press 2005) 145-155.
[140] *See, e.g.,* Kraakman, R., 'Corporate Liability, Strategies and Costs of Legal Controls' (1984) 93 Yale L J 857, 891.

stems from the fact that, in theory, the reputational capital that they have built up over many years of performing similar services for numerous clients will not be sacrificed for a single client and a modest fee. Thus, the gatekeeper, in effect, pledges reputational capital, which they would not rationally sacrifice, and that is the rationale behind their key role in maintaining the integrity of a firm.[141]

If these gatekeepers can detect offences, it will be difficult -or at least very costly- to entice them into a conspiracy. Many offences will fail because some of these outsiders will prove impossible to corrupt, other will fail because the price of corruption exceeds its potential benefits, and still others will never be attempted in the expectation that they would fail for either reason. Therefore, the primary aim is for gatekeeper liability theory to stop a class of offences that are unreachable through enterprise-level or managerial sanction.[142]

Yet, the theory that envisages all the aforementioned assumptions has been dramatically challenged by the recent corporate governance collapses.[143] It has been argued that during the 1990s auditors became compromised both by a combination of reduced legal risks for acquiescing in financial

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[141] Essentially, these gatekeepers are meant to vet offerings and their reputations are supposed to serve as the check on their thoroughness. *See, e.g.*, Sale, H. A., 'Gatekeepers, Disclosure and Issuer Choice' (2003) 81 Wash U L Q 403, 403. Furthermore, it has been argued that the motivations for gatekeepers are not only their reputational capital but also the possibility of facing legal liability that significantly exceeds the benefits from acquiescence. *See, e.g.*, Coffee Jr., J. C., 'The Acquiescent Gatekeeper: Reputational Intermediaries, Auditor Independence and the Governance of Accounting' (2001) Centre of Law and Economic Studies, Columbia Law School, Working Paper 191.

[142] *See, e.g.*, Kraakman, R., 'Corporate Liability, Strategies and Costs of Legal Controls' (1984) 93 Yale L J 857, 891.

[143] On the gatekeepers' failure, *see, e.g.*, Coffee Jr., J. C., 'Understanding Enron: It's about the Gatekeepers, Stupid' (2002) 57 Bus Law 1403, 1405. In brief, the failure of Gatekeepers can be explained on the basis of three different approaches. Whereas the first one considers that gatekeepers have lost their independence for reasons tied to the fact that acquiescence in wrongdoings favoured by management significantly exceeds the benefits from reporting them; the second approach points to the corporate culture as being the underlying reason for such misconduct; and finally, the third approach considers the lack of an effective system of protecting potential whistle blowers.

irregularities and heightened benefits that corporate management could bestow on acquiescent auditors in the form of highly lucrative consulting work. In recent years, auditors have been criticised for allowing excessive misconduct risk by not correcting small biases in managers' accounting choices and for failing to warn investors about corporate business risk, poor decisions by management and lax internal controls.[144] To that also contributes the lack of competition and, more particularly, the fact that modern audit firms do not operate in an environment of perfect competition, where if an auditor misses a fraud, its reputation will be hurt, and there will be many audit firms capable of seeking to take his/her client. On the contrary, auditors can afford to be a little less protective about their reputation when it comes to displeasing their client.[145]

In practice, certain gatekeepers let investors down and they did not do their jobs-especially in the last decade.[146] Enron in the USA and Parmalat in Europe (Italy) are the most typical demonstration of this. Referring in particular to the Enron, under the US federal system of regulation, the gatekeepers are the ones charged with reviewing the merits of the offering or other transaction. After the Enron scandal, no one doubts that the gatekeeper-accountants failed the market.[147] Similarly, lawyers and investment banks

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[144] *See, e.g.,* Coffee Jr., J. C., 'Understanding Enron: It's about the Gatekeepers, Stupid' (2002) 57 Bus Law 1403, 1405; and Coffee Jr., J. C., 'The Attorney as Gatekeeper: An Agenda for the SEC' (2003) 103 Colum L Rev 1293, 1293.

[145] *See, e.g.,* Coffee, J. C., 'Why Didn't the Watchdogs Bark?' (2007) The Conference Board Review (an interview by A. J. Vogl), at 1 and 2.

[146] *Id.*

[147] *See, e.g.,* Powers Commission Report, *'Report of Investigation by the Special Investigative Committee of the Board of Directors of Enron Corporation'* (2002) February (the Powers Report). The climax of one of the most notorious corporate scandals in US history was marked by the jury verdict that made its announcement on its sixth day of deliberations. On 25 May 2006, the jury found Ken Lay, Enron ex-CEO, guilty of all six counts and Jeff Skilling, Enron ex-CEO, was convicted on fraud and conspiracy on 19 of the 28 counts against him. On 5 July 2006, Lay dies of an apparent heart attack and Skilling's sentencing is

failed. Precisely, Enron's lawyers at Vinson & Elkins were reportedly involved in the structuring of the partnership deals and were unwilling to listen to warnings about the 'dubious nature' of those deals.[148] Apparently, the lawyers also warned in-house counsel of their fears they had about Enron deals and when 'rebuffed by Mr. Fastow';[149] they repeatedly refrained from speaking to other senior executives of the Board. Ironically, the Board was the designated client.[150] Similarly, the investment banks were subject to criticism as well. For instance, the investment bank, Merrill Lynch, reportedly fired its analyst, who angered Enron officers by rating the stock neutral.[151] Finally, the press (media) failed in its watchdog role mainly due to lack of business journalism and reporting. In principle, it is harder to do business reporting and a fundamental deficiency is the lack of financial sophistication and sceptical questioning.[152]

Thus, the important lesson revealed from the Enron collapse is that every link in the audit chain failed to discover its weak financial status and to act to correct this condition- including the audit committee of the board, the board itself, the presumably independent auditor, the market specialists in Enron stock, the stock exchange, Enron's major creditors, the credit rating

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scheduled for 23 October 2006. (For a full coverage of the Enron trial, visit http://www.washingtonpost.com/).

[148] *See, e.g.*, Kranhold, K., 'Law Firm Reassured Enron on Accounting' *Wall Street Journal* (New York, 1 & 16 January 2002) A18.

[149] Mr A. Fastow was the Chief Financial Officer of Enron Corporation from 1998-2002, and then he was fired. Mr. Fastow is expected to serve a 10-year prison sentence after admitting he masterminded fraudulent bookkeeping schemes. *See, e.g.*, Babineck, M., M. Flood and J. Roper, 'Enron Jurors Find Lay, Skilling Guilty' *Houston Chronicle* (26 May 2006).

[150] *See, e.g.*, Pollock, E. J., 'Lawyers for Enron Faulted its Deals, Didn't Force Issue' *Wall Street Journal* (22 May 2002) A1.

[151] *See, e.g.*, Opell Jr., R.A., 'Merrill Replaced Research Analyst Who Upset Enron' *The New York Times* (30 July 2002); Smith, R., 'The Analyst Who Warned About Enron' *Wall Street Journal* (29 January 29 2002) C1; and Smith, R., and A. Raghavan, 'Congress Probes Merrill-Enron Deals' *Wall Street Journal* (30 July 2002) C1.

[152] *See, e.g.*, Overholser, G., 'Journalists and the Corporate Scandals: What Happened to the Watchdog?' in J. W. Lorsch, L. Berlowitz and A. Zelleke (eds.), *Restoring Trust in American Business* (MIT Press 2005) 145-155.

agencies, the Securities Exchange Committee (SEC), the business journalists and finally the presumably reliable gatekeepers.[153] Although each group had some opportunity (and some an explicit professional obligation) to constrain corporate management and to safeguard public's trust in business, yet no one in the audit chain appeared to have had a sufficient 'incentive' to discover and report the truth. Clearly, each of these groups got caught up in powerful market pressures that undermined their commitment to 'doing the right thing', whether for clients, the general public, or both. In a handful of instances, a culture of greed compromised professionalism and produced rampant conflicts of interest on the part of professional service providers.[154]

If one expects from gatekeepers to report corporate business risk and corporate misconduct risk, then adequate incentives for them to do so must be in place, like for instance, a whistle blowing protection mechanism and/or a mechanism for compensating gatekeepers, who act in the public's interest. On the contrary, every party seemed to have been seriously discouraged from raising his concerns and acted as a 'free rider', hoping that someone else would reveal the truth and would perform the necessary audit role.[155]

Overall, gatekeepers are interposed between investors and managers in order to play a public watchdog role or a corporate responsibility gatekeeper for regulators that reduce the agency costs of corporate governance officials, stakeholders and the general public in order to protect them from careless and imprudent corporate executives. Ultimately, absent effective gatekeepers, it is

[153] *See, e.g.,* Niskanen, W. A., 'A Preliminary Perspective on the Major Policy Lessons from the Collapse of Enron' (2002) Cato Institute, at 6.
[154] *See, e.g.,* Corporate Responsibility Steering Committee of the American Academy of Arts and Sciences, 'Report of the American Academy's Corporate Responsibility Steering Committee' in J. W. Lorsch, L. Berlowitz and A. Zelleke (eds.), *Restoring Trust in American Business* (MIT Press 2005) 161-165.
[155] *See, e.g.,* Niskanen, W. A., 'A Preliminary Perspective on the Major Policy Lessons from the Collapse of Enron' (2002) Cato Institute.

reasonable to believe that market efficiency will be lower, the cost of capital higher and the structure of corporate governance imperilled.[156]

The Failing Corporate Culture amid the Absence of Effective Whistleblowers' Protection Mechanisms

Building on the discussion of factors that can hinder the realisation of the positive effects of good corporate governance, more institutions and factors (internal and external) are identified. As aforementioned, during a period of unparalleled economic growth, social and technological advancement and highly visible corporate misconduct, large-scale corporate scandals were documented to have deeper causes than just managerial opportunism and self-dealing practices.

Notwithstanding the failing role of gatekeepers, as revealed by the cross examination of their responsibilities in theory and in practice, likewise the lack of such a corporate culture –a corporate governance driven one- that would ensure the achievement of the dual corporate governance objectives (business development and the protection of shareholders' rights) is regarded as a critical component for the deepening of corporate failures. As a matter of fact those two issues (corporate culture and gatekeepers) are strongly interrelated, since it is expected that a corporate culture, as defined above, will be the main condition for ensuring two facts. First is that the corporate governance objectives are met. Second is that the role of gatekeepers is enhanced.

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[156] *See, e.g.,* Coffee Jr., J. C., 'The Acquiescent Gatekeeper: Reputational Intermediaries, Auditor Independence and the Governance of Accounting' (2001) Centre of Law and Economic Studies, Columbia Law School, Working Paper 191.

Therefore, in what follows, a review of the importance of establishing such a corporate culture is undertaken, arguing for its positive contribution to good corporate governance by setting professional corporate values and objectives and by facilitating the performance of gatekeepers' role. Finally, effective whistle-blowing protection mechanisms are discussed as a means to protect shareholders' rights and ensure company's sound functioning and performance. Similarly, the existence of such mechanism significantly facilitates gatekeepers' role to the extent that their voices can now be heard.

By definition, corporate culture describes all the web of relations, procedures and traditions within a company. In essence, it is the corporate culture that drives the organization and determines its actions, it guides how employees think, act and feel and it has been reckoned as the 'operating system' of the organization.[157]

Although some firms have been well known for their excellent and sophisticated corporate governance mechanisms, yet due to their corrupt corporate culture they could not avoid the failure. In certain cases, the people of a company may be very good and ethical people, who acted wrongly for reasons tied to corporate culture and societal expectations. More particularly, as reports from inside Enron came out, it appears that many people were concerned about the company's questionable financial practices but yet no one raised the question.[158] In any case, the Enron executives created a culture of greed, corruption, deception and self-enrichment that not only permeated

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[157] *See, e.g.,* Hagberg, R., and J. Heifetz, *'Corporate Culture / Organizational Culture: Understanding and Assessment. Telling the CEO his/her Baby is Ugly'* (2000) (Note, Hagberg Consulting Group).

[158] *See, e.g.,* Powers Commission Report, *'Report of Investigation by the Special Investigative Committee of the Board of Directors of Enron Corporation'* (2002) February.

the highest levels of management but also those were the persons that prolonged and maintained it.

Considering also the fact that in the aftermath of the Enron collapse concentrated pervasive reform and government regulation was effectuated, the real flaw in this organization is one that no amount of regulation is able to fully address: a corporate culture, which preserved bad corporate foundations and corrupted internal structures or in other words an intrinsically rotten corporate culture. Therefore, although individuals are responsible for their actions, however, unethical or illegal individual actions are sometimes symptoms of systemic problems and practices within the company.[159] Against this background, the detrimental effects of such rotten corporate culture are reflected, followed by a dramatic deepening of the impact of corporate collapses.

From a theoretical perspective, a corporate culture can make it hard (or even impossible) for ethical objections to be heard and even when they are heard, it fails to create appropriate internal structures so that those voices are taken seriously.[160] Such corporate culture is designed to suppress truth and transparency, followed by a situation where everyone in the corporation knows the truth but nobody ever tells it to anyone else.[161] Ultimately, the result is that ethical people are forced to remain silent when they see the most highly rewarded people in the firm to be the ones, who commit some of the worst wrongdoings.

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[159] *See, e.g.,* Clark, K. B., 'Corporate Scandals: Is it a Problem of Bad Apples or Is It the Barrel?' (Remarks prepared for the National Press Club, 26 February 2003, Harvard Business School).

[160] *See, e.g.,* Powers Commission Report, *'Report of Investigation by the Special Investigative Committee of the Board of Directors of Enron Corporation'* (2002) February.

[161] *See, e.g.,* Pitt, H., 'Instilling a Corporate Culture of Integrity, Ethics and Compliance-Setting the Tone at the Top' *Compliance Week Columnist* (28 September 2004).

In this connection, it appears that a critical factor for understanding a corporate culture is the extent to which the latter is leader-centric.[162] This is important, because the culture of a firm is likely to reflect the personality and attitude of the company's leaders. The behaviour that is modelled by the leader and the management team profoundly shapes and influences the final formation of the culture and the practices adopted thereof by the firm and it certainly sets the tone of the culture.[163] In a similar vein, the critical role of top management is recognised as important in the value maximization of the company mainly through its leadership and effectiveness in creating, projecting and sustaining the company's strategic vision.[164]

Furthermore, the recent corporate scandals raised important questions with regard to the role of a code of ethics in instilling proper corporate behaviours, when such code is applied within the context of a corrupt cultural environment. For instance, Enron had high ethical standards and it reminded, often, their employees about the corporations' ethics. However, after a certain point, the top management of the company paid no attention to it and consequently, it became destructive. Simply, this happened on the premises of the success that the company had, provided that the stress and societal expectations at the highest levels of management were so intense that no one's ethics could withstand it.[165]

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[162] For more reflections on the essentials for an ethical corporate culture, *see, e.g.*, Pitt, H., 'Essentials for an Ethical Corporate Culture' *Compliance Week Columnist* (25 July 2006); and Pitt, H., 'Instilling a Corporate Culture of Integrity, Ethics and Compliance- Setting the Tone at the Top' *Compliance Week Columnist* (28 September 2004).

[163] *See, e.g.*, Hagberg, R., and J. Heifetz, *'Corporate Culture / Organizational Culture: Understanding and Assessment. Telling the CEO his/her Baby is Ugly'* (2000) (Note, Hagberg Consulting Group).

[164] *See, e.g.*, Blair, M. M., 'Should Directors Be Professionals?' in J. W. Lorsch, L. Berlowitz and A. Zelleke (eds.), *Restoring Trust in American Business* (MIT Press 2005), at 79-83.

[165] *See, e.g.*, Balay, D. H., 'Close Up: Enron Debacle Offers Tough Lessons in Ethics' *United Methodist News Service* (20 May 2002).

Understanding the Importance of Establishing Effective Whistle-Blowing Mechanisms

It has been discussed that gatekeepers' role is advanced within the context of a sound corporate culture to the extent that they are recognised as an ingredient part of the organisational structure of the company. However, that alone cannot ensure that gatekeepers' voice will be heard, in the absence of an effective mechanism (such as for instance, reporting hotlines and websites) that will facilitate gatekeepers, *inter alia*, to blow the whistle when irregularities take place. Therefore, a sound corporate culture that recognises the important role of gatekeepers needs to be coupled with an effective protection mechanism for whistleblowers.

The legal manifestation of that is reflected in the provisions of Sarbanes Oxley Act that prescribes, *inter alia*, increased protection for whistleblowers.[166] More particularly, it is provided that:

(i) Publicly held companies are now required to have a venue in place to receive the reports of anonymous whistle-blowers. Section 302 of the Sarbanes Oxley Act states: *'each audit committee shall establish procedures for the confidential, anonymous submission by employees of the issuer of concerns regarding questionable accounting or auditing matters'*.[167]

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[166] *See, e.g.,* US House of Representatives, 'Public Company Accounting Reform and Investor Protection Act of 2002' (The Sarbanes-Oxley Act of 2002) Public Law No. 107-204, 116 Stat. 745 (30 July 2002).

[167] It is important to note that the Sarbanes Oxley Act requirements regarding whistle blower anonymity do not match the EU requirements arising from the European data protections laws. The EU-US confusion is created on the grounds that whistle-blowing schemes operating within the EU are likely to involve collection of personal date and so are required to comply with the EU data protection rules enshrined in the Data Protection Directive (*see, e.g.,* Council Directive (EC) 1995/46 of 24 October 1995 on the protection of individuals with regard to the processing of personal data and on the free movement of such data, OJ L281/31). Such clash of legal approaches was dramatically highlighted when a French court in September 2005 issued an order prohibiting a French subsidiary of McDonalds from establishing anonymous whistle blowing procedures on the grounds that EU data protection

(ii) After receiving a report, any investigation conducted must comply with Section 806 of the Sarbanes Oxley Act, which states that *'no publicly traded company, or any officer, employee, contractor, subcontractor, or agent of such company may discharge, demote, suspend, threaten, harass, or in any other manner discriminate against an employee in the terms and conditions of employment because of any lawful act done by the employee'*.

(iii) The Sarbanes Oxley Act provisions have made it clear that retaliation against whistle-blowers will not be tolerated. A new Section, 1513(e), has been added to Title 18 of the U.S. Code. It is now a criminal offence to retaliate against whistle-blowers, carrying penalties from a large fine to 10 years in prison.[168]

Essentially, the importance of the Sarbanes Oxley Act is centred on the fact that it establishes two enforcement regimes -one civil and one criminal- to protect people, who report on corporate fraud.[169] The civil provision creates a right to reinstatement, back pay and damages for whistle-blowers. The criminal provision makes it a felony to retaliate against a protected whistle-blower.

It follows that authorities have, at least from a theoretical point of view, recognised the importance of whistle blowers. The Sarbanes Oxley Act intends to avert the universal phenomenon of discrediting whistle blowers and treating them as betrayers. To that end, in light of the scandals, it creates the

law prevented the transfer of data without consent, thus placing the US parent company in breach of the Sarbanes Oxley Act. *See, e.g.*, Marchini, R., 'Conflict of Laws: Whistle-Blowing Hotlines under Fire in Europe' (2006) Dechert on Point (Legal Update), August.

[168] *See, e.g.*, Salem, G. R., and L. M. Franze, 'The Whistleblower Provision of the Sarbanes-Oxley Act of 2002' (2002).

[169] *See, e.g.*, US House of Representatives, 'Public Company Accounting Reform and Investor Protection Act of 2002' (The Sarbanes-Oxley Act of 2002) Public Law No. 107-204, 116 Stat. 745 (30 July 2002).

legal foundation upon which the role of whistle blowers can be significantly enhanced. Likewise, for companies and the market at large it is important fully to appreciate the gains from offering whistle blowers and employees, alternatives to silence, so as to avoid added risks of being denied important information. Yet, the success of this legislation remains to be seen.

In the light of the above, an ethical corporate culture matters, since it can bring prosperity and transparency to an organisation. On the contrary, when such culture is toxic, it can have adverse and disastrous effects. An important aspect of a sound corporate culture is that it provides the framework upon which gatekeepers' role can matter for the company as an integral part of it. Finally, as it has been revealed from the recent corporate scandals, in order for the gatekeepers' voice to be heard, the existence of an effective internal whistle-blowing scheme is fundamental.

Gatekeepers, Corporate Culture, Whistle-Blowers: The Greek Perspective

Recognising that the aforementioned conditions (gatekeepers, whistle-blowing mechanisms and corporate culture) can devalue and dramatically hinder the achievement of the dual scope of corporate governance (business development and the protection of shareholders' rights), the research focus shifts to examine the state of these conditions in the specific context of the Greek market and the Greek corporations operating thereof.

The aim of this analysis is twofold. One aim is to show that although the above three conditions are not strictly speaking country specific factors (in relation to Greece), as the ones that will be extensively discussed at the core of this thesis, they can nevertheless dramatically circumscribe the objectives of the Greek corporate governance system. The other is to demonstrate that although the structure of the Greek corporate landscape is different from the US and other jurisdictions, there are still important lessons for Greece to learn from the failures in the US and in Europe (Italy). It is crucial that fundamental provisions are devised so as to address those weaknesses in an effort to secure the Greek corporate market from similar corporate failures in the future.

This chapter closes with the examination of three important issues. First, what is the role of gatekeepers (if any at all) in the Greek corporate market? More essentially, it is examined who are really regarded as gatekeepers in the Greek context. Second, what is the Greek corporate culture? To what extent is such culture expected to ensure the achievement of the dual objectives of corporate governance. Third, what are the whistle-blowing mechanisms established to facilitate that wrongdoings are made public? How effective are those mechanisms?

Although most of the discussion is focused on the gatekeeping problems in the US market, it has to be noted that the gatekeeping problem is not confined to the US market and it is certainly an issue that concerns all countries around the world, including Europe. For instance, in the UK, the role of analysts in US investment banking and their conflicts of interests prompted the UK's Financial Services Authority (FSA) to review the work of analysts in the banking industry.[170] Similarly, in Germany, German regulators

[170] *See, e.g.*, Financial Services Authority - (FSA), *'Investment Research: Conflicts and Other Issues'* (2002) 15 Discussion Paper (July).

were investigating Deutsche Bank for selling 44 million shares of Deutsche Telekom one day after publicly restating its 'buy' rating.[171]

This discussion as to Greece reveals important insight for the corporate landscape and more specifically for the corporate governance framework that is set in this jurisdiction. As analysed above, American corporate directors depend upon their gatekeepers to a certain point. In such state of corporate affairs the strong role of gatekeepers is crucial as a means to ensure business development and the protection of shareholders' rights. Therefore, it can be explained why in diffuse ownership structures, such as those of US corporations, the role of gatekeepers is important, a testament of which are the recent corporate failures.

Putting this discussion on the important role of gatekeepers, as a means of checks and balances, into the Greek perspective, a paradox is revealed. By definition, in the case of family firms the role of gatekeepers is limited. Such importance is mainly determined by the specific ownership structures and the fact that family firms are characterised by concentrated ownership as opposed to the US diffuse ownership structures. In other words, as mentioned in the previous lines of the analysis, in concentrated ownership structures the controlling shareholders in most cases have sufficient information about the company; therefore the role of gatekeepers appears to be limited. On the other side, such state of ownership structures makes the presence of independent gatekeepers very relevant. This is so to the extent that concentrated ownership structures (e.g. family firms) absent independent gatekeepers to warn management about possible corporate wrongdoings are

[171] *See, e.g.,* Miller, S. S., 'Chaperoning Analysts: Procedure to Manage, Minimize and Disclose Conflicts' (2002) 34 Sec Reg L Rep 879.

better able to conceal self-dealing. Therefore, their operation might be to the detriment of minority shareholders' interests.

Although theory presents a paradox, the common practice in the Greek context is straightforward: gatekeepers' role is limited. Such limited role may to a certain extent excuse the limited range of professionals and intermediaries that qualify as gatekeepers. More particularly, auditors are regarded as the most common professionals that qualify as gatekeepers. This is due to the fact that all companies operating in the Greek market must have their financial reports and statements duly signed by qualified auditors. In this sense, compliance with specific auditing and accounting rules is secured by auditors. However, there are a couple of instances that reveal auditing and accounting irregularities, some of which are caught by the monitoring and supervisory activities of the Hellenic Capital Market Commission (HCMC). Similarly and most recently, the notorious hedge fund scandal of the Greek Pension Funds revealed with the most prominent way the lack of appropriate checks and balances with respect to accounting and financial reports.

Supplementary to the role of auditors as gatekeepers, the watchdog role of media is recognised.[172] The Greek media have lately assumed a critical role for corporate stability and performance and from a pure sociological perspective they perform a major democratic function to the extent that they make sure that corporate affairs are as transparent as possible.[173]

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[172] With the term 'media', we mean the radio, the press, the TV and other electronic media and the people associated with them.
[173] The level of presence of media in a society is analogous to the degree of oversight that citizens and investors can exert over public bodies and corporations. *See, e.g.,* Fritz, A., 'Watching the Watchdogs: the Role of the Media in Intelligence Oversight in Germany' (2004) Geneva Centre for the Democratic Control of Armed Forces Working Paper 138.

The Greek media, which in their majority are privately owned with only limited cases of government ownership, serve as a sort of 'unofficial opposition' or even as a 'fall-back accountability' mechanism. Critical media coverage helps to disclose flaws and misconduct, the public debate is triggered, questioning in that way the objectives and contents of some policies and decisions. Senior management of corporations is more vigilant and transparent when taking their decisions to avoid harmful revelations by the media. Therefore, the media do exert to some certain extent oversight on corporate wrongdoings and assume an important monitoring function for the performance of corporations, minimising excesses, and unfair choices. However, as in many countries around the world, there is a price to be paid if the media attacks key vested interests.

Apart from the role of auditors and the media as watchdogs, which are not strong, other professions (such as lawyers, credit rating agencies, etc.) that could qualify for the gatekeeping monitoring role are not of significance in the Greek corporate landscape. As discussed above, such state of affairs is partially explained on the grounds of concentrated ownership and the dominance of family firms.

When it comes to discussing the Greek corporate culture one important consideration comes to the fore. The presence of the owner in the management of the firm 'traditionally' incorporates the whole corporate governance framework.[174] The owners-managers of those firms exercise their power to promote and satisfy their interests, usually coupled with an unwillingness to surrender part of their control rights and power in the shake

[174] *See, e.g.*, London Business School, *'Corporate Governance for Corporate Sustainability: The Greek Reality, 1945-2000'* (in Greek) (2003) Greek Alumni Association (Kantor; Genesis Pharma SA).

of 'good governance practices'.[175] Such pattern of ownership concentration explains the findings of the London Business School survey for the Greek corporate practices to the extent that they find that family firms' governance tends not to follow hard laws. Even if there are certain rules and principles, the latter are mainly formatted by the existing corporate culture and they only cover certain operations of the firm.

As the main attribute of the Greek family-owned firms is the entrenchment of the owners-managers, the initial negative approach towards the implementation of corporate governance rules is explained. To the extent that a corporate governance system is described as a nexus of rules that impose specific obligations to the senior management of a corporation, it explains why in some cases, the senior management is not willing to comply with rules that could challenge their authority, position, or power. Such obligations may appear for family firms as a strong reason for exiting or not joining stock exchanges.[176] For instance, the introduction of independent members on the Board of Directors is not welcome in family firms because that would mean that the family members would have to transfer part of their control rights and management power to handful of independent members.

Therefore, as derives from the above facts, the Greek corporate culture is not corporate governance driven but mainly family-driven in the sense that

[175] *See, e.g.,* Mouzoulas, S., *Law 3016/2002 on Corporate Governance: Article by Article Analysis - Evaluation from Institutional Investors' Perspective* (in Greek) (Sakkoulas Publications, Athens, 2003), at 6.

[176] According to the London Business School survey examining the conduct of family firms in the Greek capital market concluded that for the period 1945 to 2000, there was a steady decline of the number of family firms that were present in the Top 100 of firms (according to total assets). While in 1945, 80 of the firms were family owned, in 2000 this number declined to 15. Evidently, the number of companies with low corporate governance standards (i.e. family firms) declines compared to the number of other listed companies in the Top 100 companies. *See, e.g.,* London Business School, *'Corporate Governance for Corporate Sustainability: The Greek Reality, 1945-2000'* (in Greek) (2003) Greek Alumni Association (Kantor; Genesis Pharma SA), at 21.

the issues of priority are the family's interests. Although such corporate culture cannot be classified as corrupt, yet it does not secure that the objectives of corporate governance are achieved. Business development and the protection of shareholders' rights (here minority ones) are safe only as long as they satisfy the family's interests.

Finally, with regard to the issue of whistle-blowing protection mechanisms and the role of whistle-blowers it is crucial to mention that there are no statutory definitions of a whistleblower either at EU level or in Greece specifically.[177] Primarily, although in Greece the whistle-blowing activity is limited, as a result of the limited protection, whenever a crime is prevented 'there is always someone behind the curtains who blew the whistle to the appropriate authorities'.[178]

Such limited use of whistle-blowing mechanisms is explained on two important grounds. One, it is the fact that there is no developed and adequate protection mechanisms for whistleblowers. In this backdrop, although the particular position of whistle-blower as an employee or conscientious citizen is recognised as a valuable source of information on fraud, there are usually practical dilemmas, which are mainly related to little or no protection against victimisation. For instance, while employees in some corporations have a freedom or competence to disclose information on the fraud of his/her employer to the authorities, they are more often than not afforded little or no protection against victimisation.[179]

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[177] *See, e.g.*, Public Concern at Work, *'Whistle-blowing, Fraud and the European Union'* (1996), at 5.
[178] *Id.* at 13.
[179] *Id.* at 14.

Two, the limited potentials of whistle-blowing protection mechanisms relate to the narrow context in which the whistle-blowing protection mechanisms are understood. More particularly, in the Greek context (similar to France, Italy and Germany) whistle-blowing is understood to be relevant only in the criminal sphere. For example, in Greece a whistle-blower 'is a person, who informs or makes an accusation against another whom he/she suspects of the violation of some penal statute'.[180] Against this backdrop, it would be suggested that the activity of whistle-blowing is broadly understood to relate to disclosures that have equal validity to breaches to civil and criminal law, associating in this setup the concept of whistle-blowing with principles of accountability.[181]

Overall, the examination of these three interrelated issues brings to the fore that in the Greek context, first, the role of gatekeepers is rather weak, demanding significant progress to be made to further strengthen the role of those gatekeepers as watchdogs for corporate wrongdoings. Second, the Greek corporate culture is not corporate governance driven but rather family driven, added to the fact that the concept of corporate governance is at its infancy for Greek corporations. Third, there is lack of whistle-blowing protection mechanisms, which makes the role of gatekeepers very difficult so that it is very simple for corporate misconducts to remain unknown to the public.

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[180] *See, e.g.,* Public Concern at Work, *'Whistle-blowing, Fraud and the European Union'* (1996), at 13.
[181] *Id.*

CHAPTER 2

A MORE CONTEXTUALISED APPROACH TO THE PRINCIPAL-AGENT THEORY

1. INTRODUCTORY REMARKS

The Purposes of this Chapter

This chapter seeks to define the theoretical aspects of corporate governance and to establish its key theoretical foundations upon which the later examination of the corporate governance concept rests. It further seeks to propose a particular approach to looking at the theoretical elements of corporate governance. The methodology of the study is informed by the principal-agent theory, which explains the initial focus of the analysis on reviewing this theory, as expressed first by Berle and Means,[182] reiterated by Coase;[183] Jensen and Meckling;[184] Fama and Jensen;[185] Aghion and Bolton;[186] and further clearly articulated by Hart.[187]

On the key assumptions of the principal-agent theory, the chapter develops arguments in favour of a more contextualised approach to corporate governance.[188] Such an approach develops around the proposition that the

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[182] *See, e.g.*, Berle, A., and G. Means *The Modern Corporation and Private Property* (The Macmillan Company, New York 1932).
[183] *See, e.g.*, Coase, R., 'The Nature of the Firm' (1937) 4 Economica 386.
[184] *See, e.g.*, Jensen, M. C., and W. H. Meckling, 'Theory of the Firm: Managerial Behaviour, Agency Costs and Ownership Structures' (1976) 3 (4) J Fin Econ 305.
[185] *See, e.g.*, Fama, E., and M. Jensen, 'Separation of Ownership and Control' (1983a) 26 JLE 301; and Fama, E., and M. Jensen, 'Agency Problems and Residual Claims' (1983b) 26 JLE 327.
[186] *See, e.g.*, Aghion, P., and J. Bolton, 'An Incomplete Contracts Approach to Financial Contracting' (1992) 59 (2) Rev Econ S 473.
[187] *See, e.g.*, Hart, O., 'Corporate Governance: Some Theory and Implications' (1995) 105 (430) Econ J 678.
[188] This term is accredited to Aguilera, Filatotchev, Gospel, and Jackson.

diversity of corporate arrangements (mainly relating to the ownership and control of firms), specific corporate governance patterns (such as the financing of firms), and approaches (e.g. policy responses and disciplining mechanisms) are mediated by their fit or alignment with situational variables arising in diverse organisational, corporate, and legal environments. The significance of such approach is that it explains the reasons for corporate governance systems to differ so much across countries.

At a theoretical level, if the principal-agent theory is viewed from a more contextualised approach, it will be evident that the theory is affected by different patterns of ownership, legal regimes, and financing modes. Those variations manifest themselves in different agency concerns, which in turn give rise to different strategies devised to align the operation of the firm with the protection of shareholders' rights and the business development (e.g. disciplining mechanisms). Therefore, such analysis aims at contributing to the general discussion of corporate governance and specifically to those corporate governance attributes and the varying disciplining mechanisms.

In its narrowest perspective, the benefits of such contextual view of the principal-agent theory are to better understand the Greek corporate governance arrangements and how the Greek corporate governance system differs from other systems. For this purpose, and besides the specific focus on the Greek situation, a brief reference to other jurisdictions (such as the USA, UK, Germany and Japan) is also made. This is important, mainly, because in the context of the increasing activism in the sphere of corporate governance around the globe, strong influence from the corporate governance practices of other countries and legal regimes can be observed. Therefore, such contextualized discussion will prove very useful for practitioners and policy makers interested in applying corporate governance in particular situations and regimes.

Furthermore, the argument for a more contextualized approach to corporate governance has additional advantages, primarily, in terms of legal and policy responses to defaults. As analyzed in the previous chapter, in light of the aforementioned corporate governance scandals, heated debate has emerged on the appropriateness of different policy responses based on hard law or regulation that draws upon soft law (such as codes based on 'comply or explain' principles). Therefore, such approach may help explain why in Greece the corporate governance framework follows the spirit and the letter of the OECD best practices and recommendations, it strongly considers the UK codes approach based on the 'comply or explain' principles and at the same time reveals a tendency to look to the US hard law approach to regulation.

The Structure of this Chapter

The second chapter seeks to discuss the corporate governance concept, based on the principal-agent theory, following a more contextualized approach. It intends to contribute to the theoretical discussion of corporate governance and aid better understanding of the varying corporate governance patterns across jurisdictions, primarily focusing on the Greek case.

The chapter is structured as follows. First, a brief review of the principal-agent theory takes place, given that much of corporate governance research is based on a universal model outlined by this theory. Second, on the basis of the diversity of corporate governance arrangements, a discussion of those context-dependent variables is undertaken in an attempt to challenge the universal character of this model. In this setup, three main legal dimensions are examined. The first is the concentrated and diffuse ownership structures, including a special aspect of concentrated ownership, that of family-owned firms, which are especially relevant as to Greece. The second element is the legal traditions, namely civil law as compared to common law, and *vice versa*. The third relates to the source of financing, a context-dependent variable that is used to separate the market-oriented from the bank-oriented corporate governance system. What therefore emerges from the above is that there appear to exist variations on the principal-agent theoretical assumptions and the agency concerns that arise thereof.

Third, the question that the above assumptions raise is what differences do these varying agency concerns have for the way in which mechanisms are devised to protect shareholders' rights and ensure business development. Against this backdrop, the main disciplining mechanisms are analysed, discussing in parallel the appropriateness of those measures in achieving the objectives of corporate governance when applied in specific contexts.

Finally, the chapter closes with the discussion on the convergence of corporate governance practices. Such analysis takes place on the grounds that pressures for change have been argued to lead to the convergence of various corporate governance practices and to the consequent call for agencies in individual countries to assess the introduction of new corporate mechanisms, so as to compete in the new global corporate governance environment.

2. THE PRINCIPAL-AGENT THEORY

The underlying problem of corporate governance, as recognised by a long tradition of scholars stretching back from Berle and Means,[189] is not solely the separation of ownership and control, management and finance or as Berle and Means put it, the *'massive dissociation of wealth from active management'*. The real problem is atomization, in the sense that individuals seek their own interests.[190]

In the state of affairs as discussed by Berle and Means, shareholders no longer have any real voice in how the corporation is being run and management is only theoretically accountable to the board of directors. An active shareholder, who more often than not owns only a small stake, has limited monitoring contribution and is characterised by lack of incentive to act. At the same time, most fragmented shareholders rationally forego involvement in management monitoring.[191] Accordingly, directors do not themselves have significant ownership interests in the property beneficially owned by others but they are entrusted with powers to use in the interest of others. This separation of ownership and control is important to the extent that it allows managers to deviate from shareholder value maximisation, given the fact that the interests and objectives of the principal (the investors) and the

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[189] *See, e.g.*, Berle, A., and G. Means *The Modern Corporation and Private Property* (The Macmillan Company, New York 1932).

[190] *See, e.g.*, Roe, M.J., 'A Political Theory of American Corporate Finance' (1991) 91 (1) Colum L Rev 10, 12.

[191] This is the literal definition of a 'free riding' state of affairs. 'Free riding' or the 'free rider problem' describes the situation when individuals could receive the benefits from group activity (or the activity of another individual) without bearing their proportional share of the costs. For more information on the concept of 'free riding' within the social science literature, *see, e.g.*, McMillan, J., 'The Free-Rider Problem: A Survey' (1979) 55 (149) The Economic Record 95; within the organisational economics literature, *see, e.g.*, Alchian, A. A., and H. Demsetz, 'Production, Information Costs and Economic Organisation' (1972) 62 (5) Am Econ Rev 777; and within the context of the principal-agent theory, *see, e.g.*, Jensen, M. C., and W. H. Meckling, 'The Theory of the Firm: Managerial Behaviour, Agency Costs and Ownership Structure' (1976) 3 (4) J Fin Econ 305.

agent (the managers) differ. Hence, such conflict of interest is the first composite element of the agency theory.

Furthermore, the second key element of the principal-agent theory is the incompleteness of contracts. The contractual view of the firm was developed by Coase;[192] Jensen and Meckling;[193] Fama and Jensen;[194] Aghion and Bolton;[195] and Hart.[196] In this context, the agency problem refers to the difficulties that financiers have in assuring that their funds are not expropriated. To that end, financiers and managers sign a contract, which specifies *ex ante* what the manager may do with the funds and how the profits are to be allocated. However, due to the fact that complete contracts are technically unfeasible, investors allocate *'residual control rights'* to managers, i.e. the rights to make decisions in unforeseen circumstances or in circumstances not covered by the contract.

Theoretically, financiers would exchange sinking their funds with retaining all residual control rights. But in practice, this is difficult for various reasons, but primarily due to asymmetric information problems, whereby typically financiers do not have the same degree or quality of information as managers do.[197] Therefore, it appears that managers are better informed and

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[192] *See, e.g.*, Coase, R., 'The Nature of the Firm' (1937) 4 Economica 386.
[193] *See, e.g.*, Jensen, M. C., and W. H. Meckling, 'Theory of the Firm: Managerial Behaviour, Agency Costs and Ownership Structures' (1976) 3 (4) J Fin Econ 305.
[194] *See, e.g.*, Fama, E., and M. Jensen, 'Separation of Ownership and Control' (1983a) 26 JLE 301; and Fama, E., and M. Jensen, 'Agency Problems and Residual Claims' (1983b) 26 JLE 327.
[195] *See, e.g.*, Aghion, P., and J. Bolton, 'An Incomplete Contracts Approach to Financial Contracting' (1992) 59 (2) Rev Econ S 473.
[196] *See, e.g.*, Hart, O., 'Corporate Governance: Some Theory and Implications' (1995) 105 (430) Econ J 678, 679-680.
[197] The asymmetrical information situation that was first described by Kenneth J. Arrow in a seminal article on health care (*See, e.g.*, Arrow, K. J., 'Uncertainty and the Welfare Economics of Medical Care' (1963) 53 (5) Am Econ Rev 941) is the case when asymmetric information creates incentives for the party with more information to cheat the party with less information. Importantly, Akerlof later used the term asymmetric information in his work so as to establish the fundamentals of asymmetrical information theory (*See, e.g.*, Akerlof, G.,

better qualified on taking decisions -the reason that financiers hired managers in the first place. Consequently, managers end up with more extensive and more significant control rights, which trigger the danger of managerial expropriation of funds and shareholders. At this juncture, lays the rationale for corporate governance as a means to constraint managerial opportunism by creating appropriate decision structures.[198] Essentially, corporate governance is called to strengthen managerial accountability and to ensure good governance structures in a firm, so that in turn investors to be encouraged for efficient investments.[199] Ultimately, corporate governance is mainly concerned with finding ways to align the interests of managers with those of investors.[200]

Overall, the principal-agent theory, as the dominant academic view of the corporate form of business organization, rests on the premises that corporate governance issues arise in an organisation whenever two conditions are present. First, there is an agency problem or conflict of interest.[201] Second, that transaction costs are such that this agency problem cannot be dealt with through a complete contract.[202] Instead, an incomplete contract will be written

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'The Market for Lemons: Quality Uncertainty and the Market Mechanism' (1970) 84 (3) Q J Econ 488).

[198] Managerial opportunism is the case in which managers are acting in such a way so as to protect their private benefits of control rather than to serve the interests of shareholders. *See, e.g.*, Shleifer, A. and R. W. Vishny, 'A Survey on Corporate Governance' (1997) 52 (2) J Fin 737, 737.

[199] *See, e.g.*, Maher, M., and T. Andersson, 'Corporate Governance: Effects on Firm Performance and Economic Growth' (1999) OECD.

[200] *See, e.g.*, Shleifer, A. and R. W. Vishny, 'A Survey on Corporate Governance' (1997) 52 (2) J Fin 737, 737.

[201] *See, e.g.*, Hart, O., 'Corporate Governance: Some Theory and Implications' (1995) 105 (430) Econ J 678, 678.

[202] *Id.*

and residual control rights will be allocated with corporate governance arrangements to be the basic solutions to these problems.[203]

3. THE CONTEXT-DEPENDENT VARIABLES

Introduction

In a historic context, the fundamentals of the principal-agent theory, as analysed in the previous section, mainly describe an Anglo-Saxon state of affairs, which is characterised, *inter alia,* by diffuse ownership, sharp separation between ownership and control, strong legal protection of shareholders, and little reliance on bank finance. However, the principal-agent theory seems to overlook the significant variations of corporate arrangements, which as the corporate governance literature has documented those are, *inter alia,* the different ownership structures, legal traditions, and the reliance on external capital.[204] The principal agent theory has been developed and explored mainly by US-based academics, which accounts for lack of attention to other systems.

Primarily, on the premises of the *'nexus of contracts'* theory,[205] agency problems may depend on the type of the contract that is signed, which in turn depends on a number of considerations, such as the ownership structure, the

[203] *See, e.g.,* Hart, O., 'Corporate Governance: Some Theory and Implications' (1995) 105 (430) Econ J 678, 678.
[204] *See, e.g.,* La Porta, R., F. Lopez-de-Silanes, and A. Shleifer, and R. Vishny, 'Law and Finance' (1998) 106 J Pol Econ 1113; La Porta, R., F. Lopez-de-Silanes, and A. Shleifer, 'Corporate Ownership Around the World' (1999) 54 (2) J Fin 471; and Shleifer, A. and R. W. Vishny, 'A Survey on Corporate Governance' (1997) 52 (2) J Fin 737.
[205] According to the 'nexus of contract' theory, it is asserted that corporations are nothing more than a collection of contracts between different parties, primarily shareholders, directors, employees, suppliers and customers. This theory is often associated with Jensen and Meckling. *See, e.g.,* Jensen, M. C., and W. H. Meckling, 'The Theory of the Firm: Managerial Behaviour, Agency Costs and Ownership Structure' (1976) 3 (4) J Fin Econ 305. Also, *see, e.g.,* Hart, O., 'An Economist's Perspective on the Theory of the Firm' (1989) 89 (7) Colum L Rev 1757, 1764.

legal tradition, etc. Therefore, in an attempt to explain the varying corporate arrangements, the principal-agent theory is examined against three different legal dimensions. First, when it comes to ownership patterns, the main inquiry relates to how much they own (referring to concentrated or diffuse ownership structures) and who owns corporations (families, banks, etc.). Second, it is argued that national legal differences, namely common-law versus civil-law legal traditions, are strongly associated with varied corporate governance outcomes. Third, the role of different types of financial systems, and their capacity to provide external finance to firms (source of financing) is relevant. All these comparative variables may help explain why corporate governance systems differ quite substantially around the world. They particularly define the nature of the agency concerns, which are strongly associated with the range of those tools used to alleviate such concerns.

The main argument developed using a more contextualised approach is that on the grounds of the diversity of corporate arrangements (relating to the ownership and control of firms; legal regimes; and the financing of firms), specific corporate governance patterns and approaches (e.g. policy responses and disciplining mechanisms) are mediated by their fit or alignment with situational variables arising in diverse organisational, corporate and legal environments.

Notwithstanding that the universality of the principal-agent theory is fundamentally challenged, still this theory provides the basis for explaining the general corporate governance framework. However, the principal-agent theory presents a limited view of corporate governance, since there are the specific corporate arrangements that are determined by situational patterns, which further define the variations in the agency concerns and demand different agency responses. The latter is evidently manifested by the different disciplining mechanisms that are devised to alleviate such concerns, as will be analysed below.

Ownership Structures: the Conflict between Concentrated and Diffuse Ownership

The main question raised is the extent to which conflicts between managers and owners are the norm. Absent a global and uniform ownership structure of firms, it appears that the specific ownership structure determines the nature and the individual attributes of that conflict and affects the nature of the agency problems between managers and other stakeholders.[206]

In more precise terms, when ownership is widely dispersed, as is typical for the US and the UK corporations,[207] the agency problems stem from the conflicts of interests between outside shareholders and managers, who own an insignificant amount of equity in the firm.[208] In that context, the primary aim of corporate governance is to minimize managerial expropriation, to strengthen managerial accountability, and to protect the interests of outside (usually minority) shareholders. This is the most dominant aspect of the principal agent theory, as applied in the Anglo-Saxon corporate governance model.

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206 *See, e.g.,* Claessens, S., 'Corporate Governance and Development: Review of the Literature and Outstanding Research Issues' (GCG Forum Donors Meeting, 13 March 2003, The Hague).
207 *See, e.g.,* La Porta, R., F. Lopez-de-Silanes, and A. Shleifer, 'What Works in Securities Laws?' (2006) 61 (1) J Fin 1.
208 *See, e.g.,* Jensen, M. C., and W. H. Meckling, 'Theory of the Firm: Managerial Behaviour, Agency Costs and Ownership Structures' (1976) 3 (4) J Fin Econ 305, 312-313.

At a theoretical level, the US and the UK corporate governance systems are classified as the 'shareholder' corporate governance models, which are characterised by widespread and diffuse shareholding; a clear separation between management control and shareholder ownership; and fairly rigorous market control and competition.[209] In this setup, the maximisation of shareholders' value and the active market for corporate control reflect the most dominant aspects of the model. It follows that shareholders can exercise control over management discretion through exit, which establishes the threat of hostile takeover. Essentially, the threat of hostile takeover has led to the increased importance of shareholder interests in the Anglo-American system over the 1980s and 1990s, during which time (at least in the 1980s) 'the fostering of an active market for corporate control was seen as one of the principal goals of company law'.[210]

The US and the UK models are regarded as the two of the most influential shareholder (or outsider) models.[211] The Anglo-American legal framework of corporate governance is characterised by placing the interests of the company and shareholders at its core. The board of directors and its

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209 On the shareholder corporate governance model, *see, e.g.*, Shleifer, A. and R. W. Vishny, 'A Survey on Corporate Governance' (1997) 52 (2) J Fin 737; Zingales, L., 'Corporate Governance' (1997) NBER Working Paper 6309; and Xanthakis M., L. Tsipouri and L. Spanos, *Corporate Governance: The Concept and Evaluation Methods* (in Greek) (Papazisis Publications, Athens 2003). It is observed that 'although the stakeholder approach encourages co-operation and commitment, is not easy to identify an appropriate maximization utility function, like profit maximization in the shareholder model'. *See, e.g.*, Spanos, L., 'The Evolution of Corporate Governance in Greece' (paper presented at the First LSE PhD Symposium on Modern Greece: Current Social Science Research on Greece, London School of Economics, Hellenic Observatory, 21 June 2003, London). On these grounds the stakeholder approach has been widely criticised. *See, e.g.*, Maher, M., and T. Andersson, 'Corporate Governance: Effects on Firm Performance and Economic Growth' (1999) OECD.

210 *See, e.g.*, Kay, J., and A. Silberston, 'Corporate Governance' (1995) 153 Nat'l Inst Econ Rev 84 an updated version of which appears in F. MacMillan Patfield (eds.), *Perspectives on Company Law, Vol. 2* (Kluwer Law International 1997).

211 In the US context, outsider models are also termed 'arm's length' systems because shareholders maintain their distance and give executives a free hand to manage. *See, e.g.*, Cheffins, B. R., 'Law, Economics and the UK's System of Corporate Governance: Lessons from History' (2001) 1 (1) JCLS 71, 72.

managers are required to direct and control the company on behalf of its shareholders. In the US and in the UK there is strong shareholder-centred capitalism, contrasting with German and Japanese bank-oriented capitalism, pursuant to which shareholders (investors) can influence the volumes of external finance. Hence, shareholders' activism is manifested in the US and UK models, as a means to exert good corporate governance.[212] Overall, an 'outsider' system is characterised by dispersed ownership and few (if any) shareholders own enough equity to have any sort of 'inside' influence.[213]

On the contrary, when ownership is concentrated in one owner (or a few owners acting in concert, as is the case of family-owned firms), who has effective control of the firm, the nature of the corporate governance ramifications vary and agency problems shifts away from manager-shareholder conflicts. In the context of such stakeholder or insider model, an alternative to the aforementioned shareholder or outsider system, the principal-agent problems will be less management versus owner but more minority shareholders versus controlling shareholders. In this case, the aim of corporate governance is the alignment of the interests of strong share block-holders and weak minority shareholders.[214]

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[212] *See, e.g.,* Morck, R., and L. Steier, 'The Global History of Corporate Governance: an Introduction' (2005) NBER, Working Paper 11062. However, while institutional investor involvement establishes grounds for greater shareholder activism, the priority of fund managers remains shareholder wealth maximisation. But, it does not appear that the movement towards greater institutional ownership of shares in 'open' or 'outsider' systems entails a move towards a stakeholding approach. *See, e.g.,* Cook, J., and S. Deakin, 'Stakeholding and Corporate Governance: Theory and Evidence on Economic Performance' (1999) ESRC Centre for Business Research, University of Cambridge.

[213] *See, e.g.,* Cheffins, B. R., 'Law, Economics and the UK's System of Corporate Governance: Lessons from History' (2001) 1 (1) JCLS 71, 72.

[214] *See, e.g.,* Roe, M. J., 'The Institutions of Corporate Governance' (2004) Harvard Law School, John M. Olin Centre for Law, Economics and Business, Working Paper 488; and Roe, M.J., 'A Political Theory of American Corporate Finance' (1991) 91 (1) Colum L Rev 10, 15.

Such a stakeholder model, which is mainly found in continental Europe, Asia (e.g. Japan) and Latin America, is characterised by concentrated ownership; cross-shareholdings or vertical pyramid holdings; long-term, committed investors; employees' participation; and relatively modest importance of the stock market and the market for corporate control.[215] The most dominant reflection of stakeholder model is the Japanese corporate governance, according to which not only shareholders and managers but also other stakeholders (e.g. employees or customers) play significant roles in the decision-making processes of firms.

Finally, in a more specific context, family ownership structure[216] within the principal-agent theory is an important consideration to examine for two reasons. One, because the specific attributes of family owned firms give rise to varying nature of agency problems although to a certain extent similar to the concentrated ownership structures, but more complicated. Second, such analysis based on a more contextualised approach is valuable in an effort to better understand not only the different situational elements, but more particularly the specific context of the Greek corporate environment, which is characterised by the domination of family owned firms.

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[215] *See, e.g.,* Maher, M., and T. Andersson, 'Corporate Governance: Effects on Firm Performance and Economic Growth' (1999) OECD; Van den Berghe, L., and L. De Ridder, *International Standardization of Good Corporate Governance* (Kluwer Academic Publishers, London 1999); Tirole, J., 'Corporate Governance' (2001) 69 (1) Econometrica 1; and Spanos, L., 'The Evolution of Corporate Governance in Greece' (paper presented at the First LSE PhD Symposium on Modern Greece: Current Social Science Research on Greece, London School of Economics, Hellenic Observatory, 21 June 2003, London).

[216] Given the lack of consensus on the definition of family enterprise, a review of the literature has revealed a long list of elements used by various authors to construct their varying definitions, e.g. the percentage of share capital owned by a family; employment of owning family in executive or other positions; the existence of non family executives or employees; whether a given family accepts that it controls its own enterprise. In this context, it is possible that in a family firm the owner might be different from the family itself, thus giving rise to far more corporate governance complexities. *See, e.g.,* Neubauer, F., and G. L. Alden, *The Family Business: Its Governance for Sustainability* (Routledge, NY 1998), at 5.

To start with, in terms of the range of the agency considerations, the family involvement renders family firms liable to face more complex corporate governance issues than non-family companies. This is so because family relationships have to be managed in addition to business relationships.[217] To that direction, studies on the complexities of family-owned businesses have shown that if no family is involved, then in the corporate governance context seven roles are identified: 1) the role of management; 2) the role of the board of directors; 3) the role of the owner (the principal); 4) the dynamics between the management and the board of directors; 5) the dynamics between the management and the owner; 6) the dynamics between the owner and the board of directors; and 7) the interrelationship between the owner, the management and the board of directors.[218] Accordingly, when a family is involved then in addition to the seven aforementioned roles, some more are identified, taking into account the role of the family and the interrelationship with the abovementioned dynamics (e.g. the management, the board of directors, and the owner).[219]

Corporate markets that have been characterised by the dominance of family firms are considered to include Japan and Greece. In such corporate setup, commonly large and wealthy families control a number of public companies (which are often organised in the form of a group of companies or conglomerates) and members of those controlling families maintain top management positions. Therefore, the agency problems in these cases of family owned corporations arise between strong block holders and weak

[217] *See, e.g.,* Cadbury Sir, A., 'Family Firms and their Governance: Creating tomorrow's Company from Today's' (2000) Egon Zehnder International.
[218] *See, e.g.,* Neubauer, F., and G. L. Alden, *The Family Business: Its Governance for Sustainability* (Routledge, NY 1998).
[219] *Id.*

minority owners, in contrast with the Anglo-Saxon norm of conflicts between strong managers and weak owners.[220]

The Legal Traditions: From Common Law to Civil Law

A further important situational variable that gives rise to specific corporate patterns is the variation in the legal families (e.g. civil law and common law traditions), which likewise affects the nature of the agency problems. The different agency dynamics are particularly explained, *inter alia*, on the grounds of the different treatment of investors' protection and the degree of their legal rights.[221] Such interrelationship has been clearly articulated by La Porta, et al., who showed that civil law countries provide investors with weaker legal rights than common laws do.[222] Similarly, common law countries give both shareholders and creditors the strongest protection, whereas French civil law countries the weakest. The same authors, also, stress that civil law's weaker legal protection is reflected by high ownership concentration.[223] Therefore, legal origins, in conjunction with considerations of ownership structure, seem to affect the nature of the agency problems.

Part of the explanation that common law countries place shareholders and other stakeholders, in certain cases, in a better position than civil law

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[220] *See, e.g.*, Becht, M, and A. Roell, 'Blockholding in Europe: an International Comparison' (1999) 43 Eur Econ Rev 1049, 1051; and Becht, M., 'Strong Blockholders, Weak Owners and the Need for European Mandatory Disclosure', Executive Report, in the Separation of Ownership and Control: A Survey of 7 European Countries, Report to the European Commission submitted on 27 October 1997 (Volume 1) ECGN.
[221] For instance, in many countries whose legal systems are rooted in British common law, the interests of shareholders are held to be paramount in most corporate decisions. However, this has not been the case throughout the rest of the world. *See, e.g.*, Millstein, I. M., 'Laying the Groundwork for Economic Growth' (2005) 10 (1) Economic Perspectives 4, 4.
[222] *See, e.g.*, La Porta, R., F. Lopez-de-Silanes, and A. Shleifer, and R. Vishny, 'Law and Finance' (1998) 106 J Pol Econ 1113.
[223] *Id.*

regimes derives from the legal institution of the fiduciary obligations of directors, as manifested in the common law context. In this context, in order to constraint the discretionary authority entrusted to managers, the latter are bound by fiduciary duties. As is explained in more detail below, the fiduciary constraints are imposed (either through the duty of care or the duty of loyalty), in an effort to minimise any self-interested actions of directors and managers. Hence, a defining principle of corporate governance (especially the Anglo-Saxon one) is that an implicit term of the contract between the principal and the agent is that the duty of the agents (managers and directors) to pursue the interests of the principal.[224]

More particularly, such fiduciary constraints imposed explicitly provide for a protection mechanism for shareholders' interests (and stakeholders'). In the United States, for instance, shareholders may institute lawsuits against directors in their own right or on behalf of the company to gain redress for an alleged breach of fiduciary duty. Such cases abound in the US with shareholder suits against Enron, Tyco and WorldCom to testify this case. Altogether, in corporate America, among other common law systems, the possibility of such suits is a strong motivation for better director performance.[225]

Greece, as a civil law country, provides investors and shareholders with a moderate level of protection. Although the current system of corporate governance, as will be analysed in more detail below, plays an important role

[224] The fiduciary duties that in common law is an important concept, is the highest standard of care imposed by common law. It describes a situation when a fiduciary is expected to be extremely loyal to the person to whom they owe the duty by not putting their personal interests before the duty and by not profiting from their position as a fiduciary. *See, e.g.*, DeMott, D. A., 'Beyond Metaphor: an Analysis of Fiduciary Obligation' (1988) 1988 Duke L J 879.
[225] *See, e.g.*, Millstein, I. M., 'The Board – Governing Beyond Where the Law Ends' (address to the ICGN 2006 Annual Conference, Washington DC, 5 July 2006), at 6.

in the protection of investors and minority shareholders, the effect of this system must not be overestimated if it is not truly internalised into the inside circles of the Greek companies (i.e. Greek companies must overcome their mistrust of corporate governance principles).[226] In this setup, one of the issues directly influencing shareholders' protection is the manner in which company directors are appointed and remunerated. Directors are elected by the General Meeting of Shareholders, which alone is competent to decide on remuneration.[227] However, the rights of shareholders as individuals are limited in Greek law. For instance, there is no provision regarding the inspection of directors' service contracts. Nevertheless, employment / service contracts and directors' remuneration are always subject to prior approval by specific resolution of the General Meeting of Shareholders.[228]

Source of Financing: Market-Oriented versus Bank-Oriented Systems

Finally, the different sources of financing upon which companies across jurisdictions rely, is another important factor when considering the diversity of corporate governance arrangements. The source of financing defines two main variations of corporate governance systems, the market-oriented, and the bank-oriented model. Whereas the former describes a state of affairs where the financing of corporations derives mainly by the market

[226] *See, e.g.*, Lambadarios, C., and M. Katsimi, 'Greece: The Principles of Corporate Governance established by Law 3016/2002 in Greece' (2005) IFLR Special Issue: The 2005 Guide to Corporate Governance.
[227] *'The General Assembly meets and can reach its decisions when at the time of the meeting the shareholders participating own at least 1/5 of the company's capital'*, Article 29, Hellenic Law 2190/1920 *on Public Limited Liability Companies* (sociétés anonymes), Official Government Gazette A37, as codified.
[228] *See, e.g.*, Pavlou, C., and I. Bokorou, 'Greece: Corporate Governance', (2003) IFLR Special Issue: Corporate Governance 2003.

and basically investors choose to invest their funds to certain corporations; the latter portrays banks' central role in the financing of corporations.

Historically, the 'market-oriented' corporate governance model is most frequently met in the US capital market. This can be explained if one looks at the legal origins of the US market stretching back in 1933, when the 1933 Banking Act[229] (most commonly known as *Glass-Steagall Act*) entered into force, creating legal barriers to banks to their taking large blocks of stock.[230] In more precise terms, this Act provides the legal mechanism giving effect to the interest of US legislators to strictly separate the banking sector from the other investment activities.[231] The rationale behind this fragmentation of capital is that US capital markets were opposed to the concentration of economic power to financial institutions in order to avert situations of domination of economic and policy decision-making. From an

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[229] *See, e.g.*, Banking Act of 1933, §16, 12 U.S.C. §24 (seventh) (1988) (the Glass-Steagall Act). The background against which the *Glass-Steagall Act* was passed was one of disorder in financial markets. The economy was in depression and there were a record number of bank failures. To the average person, it appeared the stock market crash had caused the Great Depression and banks had had a large role in the stock markets. This perception, coupled with widespread bank failures, led Congress to begin a series of investigations into market abuses and ways to reform the banking system. Congress was concerned about certain questionable activities by banks and their securities affiliates. These activities included loans made by banks to their securities affiliates, loans extended by banks to others, who wanted to buy securities from the banks' securities affiliates, banks' buying securities underwritten by their affiliate for their own or their customers' accounts, and securities affiliates buying the stock of firms that were customers of the bank. Rather than restrict these specific activities, US Congress chose to separate commercial and investment banking altogether by passing the *Glass-Steagall Act*, incorporated into the 1933 Banking Act. *See, e.g.*, Mester, L. J., 'Repealing Glass-Steagall: the Past Points the Way to the Future' (1996) FRB Phil Bus Rev (July/August). For more details on the origins of the Glass-Steagall Act, also *see, e.g.*, Benston, G. J., *The Separation of Commercial and Investment Banking: the Glass-Steagall Act revisited and Reconsidered* (OUP, Oxford 1990).

[230] American politics never allowed financial institutions to become powerful enough to control operating companies. *See, e.g.*, Roe, M.J., 'A Political Theory of American Corporate Finance' (1991) 91 (1) Colum L Rev 10, 17; and Roe, M. J., 'Political and Legal Restraints on Ownership and Control of Public Companies' (1990) 27 (1) J Fin Econ 7.

[231] By mid-19th century the separation was the norm. Although after the Depression and the World War II banks made a foray into commerce via bank holding companies, however the Bank Holding Company Act of 1956 ended that. *See, e.g.*, The Bank Holding Company Act, §4 (c) (4) - (5), 12 U.S.C. § 1843 (c) (5) – (6) (1988). *See, e.g.*, Roe, M. J., 'A Political Theory of American Corporate Finance' (1991) 91 (1) Colum L Rev 10, 17; and Roe, M. J., 'Political and Legal Restraints on Ownership and Control of Public Companies' (1990) 27 (1) J Fin Econ 7.

institutional point of view, such state of affairs suited well the US Federal Government, where policies and actions were better executed at the state level rather than at the federal level.[232]

Although, the genesis of the US corporate governance model originated from the *Glass-Steagall Act* and the separation of commercial and investment banking, the 1933 Banking Act was repealed by the enactment of the *Gramm-Leach-Bliley Act* in 1999.[233] Notwithstanding the demise of the legal origins of the US corporate governance model (as reflected by the *Glass-Steagall Act*), the US model remained unaffected. Nowadays, although the separation of commercial and investment banking had been abolished, still there is no particular role of banks in financing corporations, followed by managerial control rights, as is the case in Germany and Japan.

The US (and to a certain extent the UK) is a country with dispersed ownership structure and equity financing are viewed as market-based forms of control.[234] Such control, which is decentralized by market signals, does not have the same meaning or the same implications as the closer monitoring exercised within the framework of bilateral relations (for example that of a majority shareholder or a financial intermediary). Intermediated financing makes it possible to establish and to maintain long term relations between a firm and its capital providers. As for financial markets, they cause sanctions

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[232] On the political roots of the American corporate finance, *see, e.g.,* Roe, M. J., 'A Political Theory of American Corporate Finance' (1991) 91 (1) Colum L Rev 10, 17; Roe, M. J., 'Political and Legal Restraints on Ownership and Control of Public Companies' (1990) 27 (1) J Fin Econ 7.; and Roe, M. J., *Strong Managers, Weak Owners: The Political Roots of American Corporate Finance* (Princeton University Press 1996).

[233] Also known as the *Gramm-Leach-Bliley Financial Services Modernization Act,* Public Law No. 106-102, 113 Stat. 1338 (12 November 1999), which opened the competition among banks, securities companies and insurance companies, allowing investment and commercial banks to consolidate (e.g. Citigroup, Salomon Brothers).

[234] *See, e.g.,* Aguilera, R. V., 'Hybridization and the Heterogeneity across National Models of Corporate Governance' (2002) 3 (2) Economic Sociology 17, 19.

and reallocations of capital more rapidly by crystallizing scattered information. And this affects the trend as well as the cyclical behaviour of the economy.[235]

Conversely, the German and the Japanese corporate governance models are mainly 'bank-oriented'. Japanese and German corporate ownership is quite concentrated and their financial institutions are more actively involved in their companies than are financial institutions in the US. In particular, German banks influence industrial companies by block voting of shares they own directly; shares they hold as custodian; and shares they manage for pensions. Bankers sit on the boards of portfolio companies. It is said that the German government have wanted banks to become engines of development, gathering long-term capital, and influencing the industries and managers to which that capital was allocated.[236] Similarly, strong bank capitalism characterises also the Japanese corporate structure with the major Japanese firms to have a quarter of their stock controlled by large shareholders, typically banks.[237]

From a principal-agent perspective, the specific agency dynamics present in such state of affairs are that bankers' oversight amounts to shareholder diligence and they are entrusted with the monitoring of the governance of other firms and the right to intervene to correct governance

[235] *See, e.g.,* Pollin, J. P., and A. G. Vaubourg, 'Corporate Governance Systems and Institutional Complementarities: What Consequences for European Financial Integration?' (paper presented to 'The New Frontiers of the European Union', Marrakech 16-17 March 2005).
[236] History explains the favourable climate for powerful German banks stretching back in the Bismarck period and the German unification. In this historic context, Bismarck sought to develop German industry by creating great banks as engines of development. *See, e.g.,* Roe, M. J., 'A Political Theory of American Corporate Finance' (1991) 91 (1) Colum L Rev 10, 17; Roe, M. J., 'Political and Legal Restraints on Ownership and Control of Public Companies' (1990) 27 (1) J Fin Econ 7; and Roe, M. J., 'Some Differences in Corporate Governance in Germany, Japan and America' (1993) 102 (8) Yale L J 1927.
[237] *Id.*

mistakes. In practice, if errant managers refuse to change their ways, banks withhold credit, starving the misgoverned firm of capital. The role of banks in companies is not limited to the granting of loans, banks also hold stocks and sit in the board of directors. In fact the relation of control is much richer when the lender is also a shareholder, because it incites him to be interested in the distribution of probability of cash flows and not only in the probability of a repayment.[238] What is more, the conflict of interest between creditors and shareholders is partially erased, which reduces moral hazard, that is to say the incentive to overvalue risky investment.[239] Yet, the problem is created when banks themselves are misgoverned, then the ramifications are much worse.

Finally, in the countries where the rights of control are strongly concentrated, hostile takeover bids are obviously very rare. This is so because hostile takeovers assume significance on the grounds of the separation of ownership and control as mechanisms to restrain managerial slack and opportunism.[240]

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[238] *See, e.g.*, Pollin, J. P., and A. G. Vaubourg, 'Corporate Governance Systems and Institutional Complementarities: What Consequences for European Financial Integration?' (paper presented to 'The New Frontiers of the European Union', Marrakech 16-17 March 2005).

[239] *Id.*

[240] *See, e.g.*, Sinha, R., 'The Role of Hostile Takeovers in Corporate Governance' (2004) 14 (18) Applied Fin Econ 1291, 1291.

4. CORPORATE GOVERNANCE DISCIPLINING MECHANISMS IN CONTEXT

Introduction

The previous discussion of the principal-agent theory by using a more contextualised approach and by focusing on those context-dependent variables sharpens our understanding of the varying disciplining mechanisms employed across countries and corporate governance systems. Importantly, the analysis of those checks and balances contribute to reviewing the theoretical background of corporate governance. In addition, reference to the role of each of the following disciplining mechanisms in the specific context of the Greek market, it further contributes to better understanding the particular situation of Greece.

Primarily, the fiduciary duties of the board of directors, executive compensation schemes, independent directors, and the significant role of the gatekeepers have been recognised, *inter alia*, as fundamental disciplining mechanisms[241] and they are discussed within the context of public companies and family firms, respectively.[242]

On reflection, it is revealed that each mechanism has a different added value and disciplining effect within the context of the specific type of corporate formation. Therefore, it is difficult (and not the intention of the present analysis) to determine the 'best' mechanism. Rather, the specific type

[241] For a more detailed description of all those institutions of corporate governance, namely all those mechanisms that affect, modulate, and control the decisions made at the top of large public firms, *see, e.g.,* Roe, M. J., 'The Institutions of Corporate Governance' (2004) Harvard Law School, John M. Olin Centre for Law, Economics and Business, Working Paper 488.

[242] There is, in addition, an approach on framing the controlling shareholder structure as an alternative to techniques such as independent directors and takeovers as a monitoring device. *See, e.g.,* Gilson, R.J., 'Controlling Shareholders and Corporate Governance: Complicating the Comparative Taxonomy' (2005) ECGI, Law Working Paper 49.

of organisational structure will define those mechanisms that are most appropriate and most effective for solving the relevant agency concerns within the particular setting. Towards this consideration, in what follows, the focus is sharply limited to outlining the various disciplining mechanisms, followed by a general discussion when a specific mechanism is applied to a particular context.

The Fiduciary Obligations in the Context of the Common and the Civil Law Traditions

The fundamental principles of directors' fiduciary obligations are discussed as a means to alleviate conflicts of interest and constrain self-interested actions. They have been recognised as a key basis particularly for the Anglo-Saxon corporate governance. At a theoretical level, the fiduciary duties of directors are divided in the US into the duties of care, loyalty, and the good faith obligation.[243] The term 'fiduciary' was adopted to apply to the types of relationships falling short of 'trusts' but in which one person was nonetheless obliged to act like a trustee (e.g. in the relationship between agent-principal; director-corporation; lawyer-client; trustee-trust beneficiary, etc.).[244] On the premises of the first inception of the term, the corporate form

[243] Notably, the remit of the UK Company Law Reform was to make more detailed provisions on fiduciary duties and conflicts and to employ an objective standard replacing the subjective test on the basis of which, thus far, UK directors could escape liability fairly easily. *See, e.g.*, Ferran, E., 'Company Law Reform in the UK: A Progress Report' (2005) ECGI, Law Working Paper 27.

[244] *See, e.g.*, DeMott, D. A., 'Beyond Metaphor: an Analysis of Fiduciary Obligation' (1988) 1988 Duke L J 879, 880; and Sealy, L. S., 'Fiduciary Relationships' (1962) CLJ 69.

of business organisation provided the ground for the application and development of fiduciary principles.[245]

Basically, the defining element of the principal-agent theory, *vis-à-vis* contracts' incompleteness establishes the links between fiduciary obligations and the solving of the agency problems. More particularly, such incomplete contract is coupled with fiduciary constraints on a party's discretion to pursue self interest. In this 'gap-filling' role, the common characteristics of fiduciary relationships include the agent's commitment to exercise the discretion entrusted in a fashion that will serve the interests of the beneficiary.[246]

In more specific terms, the first legal manifestation of the fiduciary duties, the duty of care, requires that directors exercise reasonable care, prudence, and diligence in the management of the corporation. For instance, in an acquisitions process, the duty of care is interpreted as an obligation of directors to act on an informed basis after due consideration of the relevant materials and appropriate deliberation.[247] In this context, while directors may use outside experts to advise them on significant legal and financial matters affecting their analysis, directors may not delegate their central responsibilities - the duties of loyalty and care - to other decision makers.

Accordingly, the duty of loyalty to the corporation and its shareholders reflects the duty of directors to make their decisions in the absence of self-dealing or conflicts of interests.[248] In the event that a conflict exists, a director

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[245] *See, e.g.*, DeMott, D. A., 'Beyond Metaphor: an Analysis of Fiduciary Obligation' (1988) 1988 Duke L J 879, 880; and Sealy, L. S., 'Fiduciary Relationships' (1962) CLJ 69.
[246] *Id.*
[247] *See, e.g.*, Law Offices of Raimi, B. L., 'Mergers and Acquisitions: Role of Directors in the Acquisition Process', (1997), Memo, available at: http://www.moneylaw.com/pdfs/merger_pdfs/role_directors.pdf.
[248] *See, e.g.*, Millstein, I., H. Gregory, and A. Altschuler, 'USA: Corporate Governance and Fiduciary Duties: A Multi-Jurisdictional Review of the Directors Relationship to the

shall disclose the conflict immediately (and in the acquisition process, for example, he/she shall not participate in the decision process).

Finally, the trinity of fiduciary duties concludes with the good faith obligation, under which it is assumed that every contract imposes on its parties an obligation of good faith and fair dealing in its performance and enforcement.[249] More particularly, pursuant to the English company law, directors have the paramount duty of acting in a bona fide manner in the interest of the company. Specifically, the director individually owes a duty of good faith to the company, which means that he/she is a fiduciary of the company's interest.[250] Like the other two fiduciary obligations, the obligation to act in good faith, as a fundamental component of traditional fiduciary duties of care and loyalty, limits a party's discretion to use powers or advantages that it has by virtue of an agreement or by virtue of law.

The importance of fiduciary duties as disciplining mechanisms for minimizing managerial opportunism and self-interest actions is reflected in the possibility for the principal (i.e. the party that the fiduciary is owed) to request remedies from breach of a fiduciary duty. For example, according to the US law when a corporation becomes insolvent, directors owe fiduciary duties to creditors in the sense that upon insolvency the directors effectively

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Corporation' (2004) American Bar Association, Business Law Section Corporate Governance Committee (Draft).

249 The good faith obligation is articulated in the US Restatement (Second) of Contracts (§205) of 1981 and Sections 1-203 of the Uniform Commercial Code (US). *See, e.g.*, DeMott, D. A., 'Beyond Metaphor: an Analysis of Fiduciary Obligation' (1988) 1988 Duke L J 879, 892.

250 *See, e.g.*, Alexander, K., 'Corporate Governance and Banking Regulation' (2004) Cambridge Endowment for Research in Finance, Cambridge University, Working Paper 17.

become trustees of the corporate assets, which should be held first for the creditors' benefit and then for that of the shareholders.[251]

When it comes to the importance of fiduciary obligations in civil legal traditions the following can be observed. In common law countries, fiduciary duties are refined by judges on a fact driven, and case-by-case, basis. On the contrary, in civil law countries statutory law may attempt to mandate or prohibit specified actions, in a legislative effort to create a system from the bottom up. This structure may attempt to define the responsibility of corporate directors and management to investors but may not explicitly create a fiduciary principle.[252] The above describes the Greek case, whereas concepts of fiduciary duty have their roots in a system of ancient Greek logic that became known as the natural law; however there is no explicit reference in Greek laws to fiduciary duties, contrary to common law countries,[253] nor are there strong provisions for breach of such duties in Greece.

More particularly, the fiduciary obligations of directors of Greek corporations are implied in the legal provisions governing two important issues. One, it is the insider trading. Two, it is the conflicts of interest. Both imply breach of fiduciary duties to the company and the shareholders when directors either use inside information for personal interest (insider trading) or

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[251] *See, e.g.*, American Bar Association, 'Fiduciary Duties and Potential Liabilities of Directors and Officers of Financially Distressed Corporations', Memorandum (22 August 2002) citing *American National Bank v. Mortgage America Corporation*, 714F. 2d 1266, 1268-69 (5th Cir. 1983); and *Geyer v. Ingersoll Publ'n Co.*, 621 A. 2d 784, 787-790 (Del. Ch. 1992), at 4. See also in that regard Conaway, A. E., 'Re-examining the Fiduciary Paradigm at Corporate Insolvency and Dissolution: Defining Directors' Duties to Creditors' (1995) 20 (1) Del. J. Corp. L.

[252] *See, e.g.*, Millstein, I. M., 'Non Traditional Modes of Enforcement' in I. M. Millstein, S. G. N. Bajpai, E. Berglöf and S. Claessens (eds.), *Enforcement and Corporate Governance: Three Views* (Global Corporate Governance Forum, 2005) Focus 3, 5.

[253] In a similar vein with the concept of the fiduciary duties, the main point of the natural law, as codified by the Greeks, Romans and English is to inhibit the abuse of power by those in a position of influence. *See, e.g.*, Walker, L. J., 'The Nature of Fiduciary Duty' *Wall Street Journal* (December 2002).

seek their own interests to the detriment of the company's interest (conflict of interest). However, the difference of those provisions implicitly prescribing the fiduciary obligations with the ones, for example, in the USA are strongly associated with their disciplining effects, their scope (conservative versus expanded[254]), but most significantly the implementation. It follows that main difference is that the US laws establishing breach of fiduciary obligations are implemented;[255] in Greece people do not hesitate breaking the law, in the absence of consequences.

Back in the 1990s, in the Greek capital market, insider trading was not just a common practice; it was the status quo.[256] This is outrageous if one considers that as early as in 1988 the Greek state explicitly made insider trading a criminal offence.[257] Such paradoxical situation is mainly due to the following reasons. First, the great majority of the Greek listed companies are family-owned. Second, the Greek business environment is a 'small world' where everybody seems to know each other and many people fulfil multiple roles. Third, the Greek market, despite its exponential growth in the last decade, is still lacking in depth. Fourth, apart from the fact that Greece has a

[254] Canadian law, for example, seems to have developed a more expansive view of fiduciary obligation, more so than American law, whilst Australian law and British law have developed more conservative approaches than either the USA or Canada.

[255] 'US law on insider trading, implemented by SEC, in most of its aspects is not more complete or strict than the Greek law. The difference is that it is implemented'. *See, e.g.*, Mathiopoulos, C., *Investor's Small Guide: the Athens Stock Exchange* (in Greek) (Estia, Athens 1996).

[256] *See, e.g.*, Lekkas, P., 'Insider Trading and the Greek Stock Market' (1998) 7 (4) Bus Ethics Eur Rev 193, 196.

[257] *Id.* at 196 and 199. Pursuant to article 30, Hellenic Law 1806/1988, as amended by the Hellenic Law 3606/2007, 'whoever, having acquired confidential information on a company by providing his services, either permanently or temporarily, [...] exploits such information, either personally or though another person [...] with the purpose to achieve substantial financial benefit [...] will be punished by at least three months of imprisonment and a fine. *See, e.g.*, Hellenic Law 1806/1988 *Amendment of Legislation Concerning the Securities Exchanges and Other Provisions*, Official Government Gazette A207/ 20.09.1988, as amended by Law 3371/2005 *on HCMC issues and other provisions*, (Official Government Gazette A178/ 14.07.2005) and Law 3606/2007 *Markets in Financial Instruments*, Official Government Gazette A195/ 17.8.2007.

historic record of weak implementation of legislation, there is also a lack of political will and initiatives to intervene in an effort to reverse the problem of insider trading.[258]

All the above country-specific, context-dependent, variables fertilise the ground for insider trading activities, since power is concentrated, conspiracies are easy to construct, and there is potential for constant flow of inside information throughout the system.[259] Any initiatives to deal with insider trading are constantly postponed and undermined by this web of people that seem to have gained much from insider trading activities.

Therefore, three important things can be concluded. First, laws regulating insider trading are not implemented as a result of strongly prevailing country-specific factors, which further explain the overall status of corporate governance framework, as is analysed in the chapters that follow. Second, and most importantly, on the grounds of the weak insider trading legal framework, the meaning of fiduciary duties, as established through the insider trading laws, is limited. Unrestricted insider trading activities permits directors to indulge in greed and to breach their fiduciary duties to the company and its shareholders.[260] This duty has strong moral and legal justification and is a fundamental corporate governance disciplining mechanism. However, in the specific context of the Greek capital market, it is de facto eliminated on accounts of the specific web of business, ethical, and legal standards. Third, to strengthen directors' fiduciary duties, a specific proportion of the members of the board of directors must be independent.

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[258] *See, e.g.,* Lekkas, P., 'Insider Trading and the Greek Stock Market' (1998) 7 (4) Bus Ethics Eur Rev 193, 196.
[259] *Id.*
[260] *Id.* at 195.

Otherwise, it is reckoned that boards crowded with insiders can hardly challenge any management decision and they only serve the interests of the top executive, *vis-à-vis* the CEO.[261] In any case, such state of affairs can have adverse effects for shareholders' value and business development.[262]

To a certain extent, the same rationale and argumentation applies when analysing the issue of conflict of interests, which likewise implicitly entails fiduciary obligations of directors to the company and the shareholders. With regard to the conflicts of interest, article 1 of the Hellenic Law 3016/2002[263] defines board members' primary responsibilities and obligations towards listed, in organized stock exchange market, companies as the continuous pursuit of the increase of the long term, corporate, financial value in parallel to the defence of general company interest, thus avoiding any explicit reference to shareholders' or even stakeholders' expectations. However, shareholders' legitimate interests are addressed by a series of company provisions mainly included in the Hellenic Law 2190/1920[264] specifying their rights and their equitable treatment. The same law emphasizes that, at all instances, board members or third parties duly authorized by the board must not seek after their own interests in breach of company's paramount interests.[265]

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[261] *See, e.g.*, Mavrides, M., and M. Olympios, 'Governance Issues in Family-Owned Public Companies and Consequences on Shareholder Value' (2004) Cyprus College School of Business, Laboratory for Business, Ethics and Society (LaBES), Working Paper.
[262] *Id.*
[263] *See, e.g.*, Hellenic Law 3016/2002 *on Corporate Governance, Board Remuneration and Other Issues*, Official Government Gazette 110/ 17.05.2002 as amended by Law 3091/2002, (Official Government Gazette A330/ 24.12.2002). [Hereinafter the Corporate Governance Law of 2002].
[264] *See, e.g.*, Hellenic Law 2190/1920 *on Public Limited Liability Companies* (sociétés anonymes), Official Government Gazette A37, as codified.
[265] *See, e.g.*, Alexakis, S., 'Incorporation of OECD Principle of Corporate Governance in Greek Securities Legislation' (2005) *LawNet.gr.*

From the above analysis, it is confirmed that different jurisdictions, legal families, and ownership structures articulate fiduciary duties in different modes. Perhaps the legal prescription of fiduciary duties is similar across countries but their disciplining effect is largely dependent on situational and contextual variables, i.e. country specific factors.

Executive Compensation Schemes

In further deepening our understanding of different disciplining mechanisms used to alleviate the varying agency problems, the focus of the analysis shifts to briefly discuss the role of executive compensation schemes from a more contextualised point of view. On the grounds of certain context-dependent variables specific corporate governance disciplining mechanisms may be interpreted as the firm's optimal response to its agency problems. Therefore, parallel to explaining the above situation, this analysis expands our understanding of executive compensation policies.

At a theoretical level, the greater an executive's ownership stake in a firm, the stronger will be his / her incentives to efficiently manage assets-in-place and to spot potentially profitable opportunities. This is so since the executive bears direct financial consequences of his / her decisions.[266] In addition, a growing literature has focused on the links between performance and compensation, in the sense that excellent performance of directors will be awarded by increased compensation package.

In this setup, the executive compensation schemes have been the subject of immense and growing public concern given the existing mismatch

[266] *See, e.g.*, Chung, K. H., and S. W. Pruitt, 'Executive Ownership, Corporate Value, and Executive Compensation: A Unifying Framework' 20 (7) (1996) JBF 1135, 1137.

between performance and remuneration.[267] According to the dominant approach to the study of executive compensation, managers' pay arrangements are viewed as a (partial) remedy to the agency problem.[268] There are many mechanisms through which compensation policy can provide value increasing incentives, including performance-based bonuses and salary revisions, stock options and performance-based promotion, and dismissal decisions.[269]

However, lack of correlation between performance and remuneration is particularly evident in family firms, including the majority of Greek corporations. This is explained on the grounds of the 'command and control' system upon which family firms rely.[270] More particularly, in family firms, there is no need to rely on indirect mechanisms of control, such as equity compensation or stock options, in order to provide incentives to the management. Rather, family firms rely on a 'command and control' system

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[267] Although it well exceeds the scope of the present research, it is interesting to note that it is argued that while executive compensation represents a means to solve the agency problem, it must be recognised that the design of compensation arrangements is also partly a product of this same agency problem. Therefore, good theoretical and empirical reasons exist for concluding that managerial power substantially affects the design of executive compensation in companies with a separation of ownership and control (e.g. public companies). *See, e.g.,* Bebchuk, L. A., and J. M. Fried, 'Executive Compensation as an Agency Problem' (2003) 17 (3) J Econ Perspectives 71, 72; and Bebchuk, L. A., and J. M. Fried, *Pay Without Performance: the Unfulfilled Promise of Executive Compensation* (Harvard University Press 2004).

[268] There is a large theoretical and empirical literature on the role of incentive contracts in ameliorating agency problems. *Inter alia, see, e.g.,* Jensen, M. C., and K. J. Murphy, 'Performance Pay and Top Management Incentives' (1990) 98 (2) J Pol Econ 225; Murphy, K. J., 'Executive Compensation' in O. Ashenfelter, R. Layard and D. Card (eds.), *Handbook of Labour Economics* (Elsevier, 1999) 2485-2563; Bebchuk, L. A., 'Making Directors Accountable' *Harvard Magazine Forum* (Nov – Dec 2003); and Core, J. E., W. R. Guay and D. F. Larcker, 'Executive Equity Compensation and Incentives: a Survey' (2003) 9 (1) FRBNY Econ Pol Rev 27.

[269] For an estimate of the magnitude of the incentives provided by each of these mechanisms, *see, e.g.,* Jensen, M. C., and K. J. Murphy, 'Performance Pay and Top Management Incentives' (1990) 98 (2) J Pol Econ 225, 261-262.

[270] *See, e.g.,* Coffee Jr., J. C., 'A Theory of Corporate Scandals: Why the US and Europe Differ?' (2005) Centre of Law and Economic Studies, Columbia Law School, Working Paper 274, at 11.

because, unlike public companies, they can directly monitor and replace management.[271]

In addition, it is interesting to note that C.E.O. founders and their family members usually tend to place shareholder wealth maximisation at a lower point on the managerial hierarchy than to do the C.E.O.'s of non founder firms.[272] In a similar vein, the role of executive compensation schemes to the Greek corporations (e.g. family firms) is shown from measuring the increase of the level of the firm's intangible assets. According to the findings of Chung and Pruitt, it is recorded that firms whose C.E.O.'s are also the founders (entrepreneurs) may exhibit lower levels of corporate intangibles than non-founder firms.[273]

Therefore, it appears that the disciplining effects of executive compensation are limited within the context of the Greek corporations. This is mainly explained on the grounds of ownership structures as the specific situational variables.

Independent Directors

Furthermore, independent directors as a disciplining mechanism to the agency problems are also recommended by various corporate governance codes, in order to minimise any complications from the combination of the roles of C.E.O. / Chairman. A key principle in the majority of corporate governance codes is the clear division of the responsibility for running the

[271] *See, e.g.,* Coffee Jr., J. C., 'A Theory of Corporate Scandals: Why the US and Europe Differ?' (2005) Centre of Law and Economic Studies, Columbia Law School, Working Paper 274, at 11.
[272] *See, e.g.,* Chung, K. H., and S. W. Pruitt, 'Executive Ownership, Corporate Value, and Executive Compensation: A Unifying Framework' 20 (7) (1996) JBF 1135, 1153-1154.
[273] *Id.*

board and the executive responsibility for running the company's business. The underlying notion is that no one individual should have unfettered powers of decision.[274]

In this spirit, the Cadbury Report (UK) recommended that there should be a strong independent element to the board to prevent chief executives from becoming too powerful.[275] This stance was reiterated later in the text of the Combined Code.[276]

Although increased director independence could be beneficial, there are concerns about the positive relationship between independent directors and good performance of boards.[277] Evidence to this direction is provided by the recent corporate failures (e.g. Enron, WorldCom) where many of the directors of those companies would have qualified as independent directors under the existing rules.[278]

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[274] *See, e.g.*, Maier, S., 'How Global Is Good Corporate Governance?' (2005) EIRIS August, at 8.

[275] *See, e.g.*, Committee on the Financial Aspects of Corporate Governance (The Cadbury Committee), '*Financial Aspects of Corporate Governance*' (1992) December (the Cadbury Report), Principle 4.9.

[276] The Combined Code provides that all the members of the board committee that determines the remuneration of the executive directors should be independent non-executive directors. In addition, at least three non-executive directors must sit on the company's audit committee and they must form the majority on that committee. *See, e.g.*, Committee on Corporate Governance, '*Principles of Good Corporate Governance and Code of Best Practice*' (1998) June (the Combined Code).

[277] The first large scale (sample of about 950 large US firms), long-time horizon study finds no consistent evidence that the proportion of independent directors affects firm performance, across a wide variety of stock price and accounting measures of performance. *See, e.g.*, Bhagat, S., and B. S. Black, 'The Uncertain Relationship between Board Composition and Firm Performance' (1999) 54 Bus Law 921; Bhagat, S., and B. S. Black, 'Board Independence and Long-Term Firm Performance' (1998) Centre of Law and Economic Studies, Columbia Law School, Working Paper 143. Also, *see, e.g.*, Romano, R., 'Corporate Law and Corporate Governance' (1996) 5 (2) Industrial & Corp Change 277, 287- 294 that identifies the benefits accruing to equity investors from independent board of directors and provides a review of those empirical and event studies that measure the effects and correlations of board of directors' composition; and Romano, R., 'The Sarbanes-Oxley Act and the Making of Quack Corporate Governance' (2005) 114 Yale L J 1521.

[278] *See, e.g.*, Bebchuk, L. A., 'Making Directors Accountable' *Harvard Magazine Forum* (Nov – Dec 2003).

When it comes to discussing the important role of independent directors within the specific shareholding structure of family owned businesses,[279] the following considerations come to the fore. First, the presence of independent directors in the family boardroom is important, in order to safeguard sound decisions and family control over management. Second, independent directors have a special value for family firms, as an effective mechanism to mitigate family opportunism.[280] Third, independent directors are in better position for tackling specific problems or issues, and especially in the field of strategy, if they ask the right questions.[281]

Therefore, the case is established for the increased importance of independent directors in family firms compared to the other disciplining mechanisms, such as director's fiduciary duties and executive compensation schemes.

Gatekeepers' Role

Finally, the significant role of gatekeepers, as the reputational intermediaries, describes another effective deterrence strategy for agency conflicts. Essentially, the central role of gatekeepers and the quality of the information that they provide to directors and managers are found to have a positive relationship with the good performance of corporations, as

[279] The authors find that investment companies; other employees; industrial partners; and other shareholders participate as shareholders in non-family firms more often than in the case of family firms. *See, e.g.*, Van de Berghe, L. A. A., and S. Carchon 'Agency Relations within the Family Business System: An Exploratory Approach' (2003) 11 CG 171, 180.
[280] *See, e.g.*, Mavrides, M., and M. Olympios, 'Governance Issues in Family-Owned Public Companies and Consequences on Shareholder Value' (2004) Cyprus College School of Business, Laboratory for Business, Ethics and Society (LaBES), Working Paper, at 8 and 37; and Cadbury Sir, A., 'Family Firms and their Governance: Creating tomorrow's Company from Today's' (2000) Egon Zehnder International, at 28.
[281] *See, e.g.*, Cadbury Sir, A., 'Family Firms and their Governance: Creating tomorrow's Company from Today's' (2000) Egon Zehnder International, at 28-30.

documented by the corporate scandals of the post 2001 period. (e.g., Enron, WorldCom), as analysed in the previous chapter.

On the theory that the gatekeeper will receive little, if anything, from corporate involvement in crime or misconduct, it is assumed that they can be deterred from wrongdoing more easily than the corporation or its managers, who may profit handsomely from crime and wrongdoing. If these gatekeepers can detect offences, it will be difficult -or at least very costly- to entice them into a conspiracy, since that would have a great cost on their long established reputation capital. It follows that many offences will fail because some of these outsiders will prove impossible to corrupt, other will fail because the price of corruption exceeds its potential benefits, and still others will never be attempted in the expectation that they would fail for either reason. Therefore, the primary aim is for gatekeeper liability theory to stop a class of offences that are unreachable through enterprise-level or managerial sanction.[282]

As discussed in more depth in the previous chapter, American corporate directors depend upon their gatekeepers to a certain point, reflecting in that way that in diffuse ownership structures, (e.g. US and UK corporations) the role of gatekeepers is important. On the contrary, in the specific context of Greek corporations (*vis-à-vis* family firms or concentrated ownership structures) the role of gatekeepers (auditors, the media, credit rating companies, or other professionals, such as lawyers, notaries, etc.) appears to be limited. This is so mainly because in concentrated ownership structures the controlling shareholders in most cases have sufficient information about the company; therefore the role of gatekeepers appears to

[282] *See, e.g.*, Kraakman, R., 'Corporate Liability, Strategies and Costs of Legal Controls' (1984) 93 Yale L J 857, 891.

be narrow. However, the presence of independent gatekeepers is also substantial as a means to bring to the fore possible wrongdoings and self-dealing instances in family firms.

5. CONCLUDING REMARKS: THE DYNAMICS OF CONVERGENCE OF CORPORATE GOVERNANCE SYSTEMS

In this last part, the basics shared and the main differences between several corporate governance patterns across countries were discussed. It is revealed that national corporate governance systems differ dramatically along a number of seemingly important dimensions. Partly, those differences are explained upon path dependence assumptions and on account of situational variables, such as political, historical, cultural and organisational variations, proving that a convergence scenario is unlikely. Such context-dependent dimensions prove a convergence of corporate governance systems neither possible nor desirable.

Although some countries may adopt part of the Anglo-Saxon or other prevailing corporate governance practices, it does not necessarily mean that their systems, as a whole, will converge. Rather it is argued that since there is not a uniform application of such practices, convergence can be only witnessed in isolation to the extent that practices converge, but not systems.

For instance, the bank-oriented corporate governance systems, (as the Japanese and the German one) although they share many common elements, nevertheless present a number of variations. Unlike German co-determination law, which opens the supervisory board to employee representatives, the Japanese law does not give employees or their representatives any status as a constituent of the corporation. Accordingly, the stakeholder Japanese model has left limited -if at all- role for shareholders, whereas the board of directors manages companies.

Similarly, the Anglo-Saxon, outsider, corporate governance system (UK and US), presents specific variations. To name just one that whereas the UK corporate governance system is a principles-based one stemming primarily from the Revised Combined Code, the American one is more a gatekeeping rule-based model as envisaged by the Sarbanes Oxley Act.[283] The UK experience has showed that the most effective corporate governance is developed consensually, as a result of debate and general agreement. explain Accordingly, changes can only move forward incrementally when they are supported by the business community and public opinion. Such approach substantially differs from the approach adopted in the US in the Sarbanes Oxley Act. In general, the US 'rules-based' approach is oriented towards mandatory compliance with legislation and stock exchange requirements, with a much greater emphasis on regulatory enforcement rather than voluntary compliance.[284] Hence, the UK approach is in the form of 'comply or explain', as envisaged by the Revised Combined Code.[285]

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[283] *See, e.g.*, US House of Representatives, 'Public Company Accounting Reform and Investor Protection Act of 2002' (The Sarbanes-Oxley Act of 2002) Public Law No. 107-204, 116 Stat. 745 (30 July 2002).

[284] On the pros and cons of the principles- versus rules-based approaches, *see, e.g.*, Broshko, E. B., and K. Li, 'Corporate Governance Requirements in Canada and the United States: a Legal and Empirical Comparison of the Principles-based and Rules-based Approach' (2006) Sauder School of Business, Working Paper, available at SSRN, at 3-5.

[285] The method of 'comply or explain' has been adopted by numerous countries. More particularly, the Higgs Report (*see, e.g.*, Department of Trade and Industry -(DTI), '*Review of the Role and Effectiveness of Non-Executive Directors*' (2003) (The Higgs Report) January), in the UK, supports this method, along with the High Level Group of Company Law experts

To continue, in both US and UK corporate governance patterns, managerial incentive schemes are common, hostile takeovers are observed quite frequently; the labour market for top managers is liquid and active; and employees' participation in the corporate administration is not addressed (in sharp contrast with the German and the Japanese style of corporate governance).

The discussion on the convergence tendencies of corporate governance systems reveals that although a number of reforms took place, they could not challenge the core of their structure. For instance, besides the evidence for a move to stock markets; for share ownership to relax; for banks in Germany to selling off their equity; and for keiretsu structures to unravel; the German and Japanese corporate governance are still insider control systems with a clear stakeholder orientation.

At all instances, history proves that although there is a certain degree of influence on specific corporate governance practices; the corporate structures of each country heavily depend upon the specific political, historical and cultural attributes, therefore convergence of systems would most probably violate the prevailing rules and undermine long standing precedent. A theoretical manifestation of that is Roe's 'path dependency' analysis according to which convergence seems unlike to progress substantially as long as countries retain their specific political and historical traditions.[286]

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that were commissioned by the European Commission to review methods to modernise company laws and in the EU and possible corporate governance convergence.

[286] *See, e.g.,* Roe, M. J., 'Political Preconditions to Separating Corporate Ownership from Control' (2000) 53 (3) Stan L Rev 539, 560; and Roe, M. J., 'Social Conflict and the Institutions of Corporate Governance' in M. J. Roe (eds.), *Political Determinants of Corporate Governance: Political Context, Corporate Impact* (OUP, Oxford 2003) at 27-46.

However, in the context of the European Union, there is a heated debate on the convergence of national corporate governance systems. Such debate is manifested by the unsuccessful proposals for the fifth Company Law Directive; the adoption of the Regulation on the Statute of the European Company;[287] and the initiative to modernise company laws and corporate governance rules.[288]

Essentially, a convergence of national corporate systems in the EU context seems difficult on the basis of two primary impediments. First are the differences of company laws and corporate governance systems of Member States, which reflect their different corporate cultures and their varying sources of finance. The second obstacle refers to the EU procedure itself for adopting and implementing Directives and Regulations. In this EU setup, although formal convergence of systems is not possible, a more informal convergence and influence of corporate governance practices is evident across EU member countries.

In reviewing the limitations of harmonization and convergence of EU company laws, the first benchmark is the failure of the proposals for a fifth Company Law Directive, which sought, *inter alia,* to coordinate Member States' legislation on the structure of public limited companies. The increased political deadlock revealed the fundamental differences between Member States' traditions in the company law field and Member States' unwillingness to adopt detailed and stringent rules.

Also, the convergence thesis from a path dependence angle is examined by Bebchuk, L. A., and M. J. Roe, 'A Theory of Path Dependence in Corporate Governance and Ownership' (1999) Stan L R 127.

[287] *See, e.g.,* Council Regulation (EC) 2157/2001 of 8 October 2002 on the Statute for a European Company (SE) [2001] OJ L294/1.

[288] *See, e.g.,* Commission Communication COM(2003)284final of 21 May 2003 on Modernising Company Law and Enhancing Corporate Governance in the European Union – A Plan to Move Forward (The Action Plan).

On the contrary, the enforcement of the two binding legislative texts that establish the European Company[289] and the adoption of the Directive on cross border mergers[290] reflect the general convergence for corporate formations. To the same convergence path lead the EU initiatives to modernise company laws and strengthen corporate governance practices (e.g. the Action Plan[291]), which coincides with the Parmalat affair.

More particularly, in the Action Plan consultation stage, the opinion of the vast majority of Member States was that there is neither need nor practical benefit from introducing an EU Corporate Governance Code, a view which was confirmed by the High Level Group and formally stated in the Communication for the '*Action Plan*'.[292]

Hence, it was concluded that the 'EU should not devote time and effort to the development of a European corporate governance code'. Rather, a more valuable area for the European Commission is to focus its efforts on the reduction of legal and regulatory barriers, such as for instance with regard to

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[289] The European Company is a legal instrument based on European Community law that gives companies the option of forming a European Company – known formally by its Latin name of 'Societas Europea' (SE). An SE can operate on a European-wide basis and be governed by Community law directly applicable in all Member States. The Statute for the European Company reduces the legal and practical constraints and the compliance cost deriving from twenty-five different legal systems The Statute for the European Company is established by two pieces of legislation: (i) Council Regulation (EC) 2157/2001 directly applicable in Member States establishing the company law rules (*See, e.g.*, Council Regulation (EC) 2157/2001 of 8 October 2002 on the Statute for a European Company (SE) [2001] OJ L294/1); and (ii) Council Directive (EC) 2001/86 of 8 October 2001 supplementing the Statute for a European Company with regard to the involvement of employees [2001] OJ L294/22 (which will have to be implemented in national law in all Member States) on worker involvement.

[290] *See, e.g.*, Council Directive 2005/56/EC of 26 October 2005 on Cross Border Mergers of Limited Liability Companies OJ L310/1.

[291] *See, e.g.*, Commission Communication COM(2003)284final of 21 May 2003 on Modernising Company Law and Enhancing Corporate Governance in the European Union – A Plan to Move Forward (The Action Plan).

[292] Notably, the vast majority of responses to the Consultative Document on the High Level Group's Final Report rejected the creation of a European corporate governance code. *See, e.g.*, Final Report of the High Level Group of Company Law Experts on a modern regulatory framework for company law in Europe (2002) at 9. Also, *see, e.g.*, High Level Group of Company Law Experts, 'A Modern Regulatory Framework for Company Law in Europe: a Consultative Document of the High Level Group of Company Law Experts' (2002) 25 April.

shareholder engagement in cross-border voting (the so-called 'participation barriers'), or the reduction of barriers to shareholders' ability to evaluate the governance of companies (the so-called 'information barriers').[293] The adoption of the Directive on shareholders' rights confirms this stance.[294]

Therefore, although the EU initiative has focused on a number of rules that can create a level of convergence, the EU should not strive to create a single European corporate governance code. Such effort seems difficult given that the underlying company laws in Member States are not harmonized in key areas and other conditions, which discipline company governance. Similarly, such adoption would not contribute constructively to the improvement of corporate governance in the EU, as this code would have either to allow for many different options or confine itself to abstract principles. The attempt to harmonise all the elements of a European code is a time demanding project with uncertain results. Perhaps, the active role for the European Commission in the area of corporate governance and company law can be fleshed out through the application of the new Open Method of Coordination.[295]

Finally, a decisive parameter that significantly impedes the convergence of national policies in the EU context, apart from national sovereignty arguments, is the inflexibility of the Directives and Regulations, as binding legislative texts. As a matter of fact, the core problem rests with the

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293 *See, e.g.*, Weil, Gotshal and Manges LLP, 'Comparative Study of Corporate Governance Codes Relevant to the European Union and Member States' (2002) Final Report & Annexes I-III (January). For instance, important rules that can significantly reduce barriers within the internal market are the Prospectus Directive, the MiFID, the Market Abuse Directive, or the Transparency Directive.

294 *See, e.g.*, Council Directive (EC) 2007/36/EC of 11 July 2007 on the Exercise of Certain Rights of Shareholders in Listed Companies [2007] OJ L184/17.

295 In that context, *see, e.g.*, Mavrommati, S., and C. Papathanassiou, 'Modified Open Method of Coordination for Corporate Governance' (2006) 17 (6) EBLR 1637.

procedure itself for adopting and implementing Directives and Regulations, which requires all 27 EU Member States to consent.[296] This long and time consuming procedure may be detrimental to the contents and the quality of the produced texts, since norms cannot easily and quickly be adopted keeping the pace of the fast changing conditions of capital markets.

To sum up, whereas a number of key corporate governance practices have been a useful point of reference for other jurisdictions (such as for instance the 'comply or explain' principle), those practices are not in all respects suitable for adoption by them. Similarly, whereas a certain degree of influence in corporate governance practices between different countries is evident, convergence of systems seems unlikely. By and large, experience, empirical studies, and a more contextualised approach in explaining corporate governance issues support the proposition that 'one size does not fit all'.

[296] Notably, this impediment has been long recognised by the Commission and to that end a review of the decision-making procedures for adopting EU legislation has been assigned to a Committee chaired by Alexandre Lamfalussy (the Lamfalussy Committee) that examined the problem and recommended a tiered decision making process for EU legislation, the so-called Lamfalussy process. The Lamfalussy process distinguished four levels of decision-making, with the first level of legislation, which only relates to framework principles and the definition of Commission implementing powers, to be adopted by the Council and the European Parliament following a Commission proposal under the co-decision procedure. Technical details for adopting Level 1 framework principles should be agreed at a second level by the Commission and Member States' experts under the so-called 'comitology' procedure. Level 3 and 4 of the Lamfalussy procedure cover supervision of Member States implementation of the Directives. In general, the success of the Lamfalussy process is still to be seen, since all four levels have been tested only for the adoption of the Market Abuse Directive (*See, e.g.,* Council Directive (EC) 2003/6 of 28 January 2003 on insider dealing and market manipulation (market abuse) [2003] OJ L96/16 (the Market Abuse Directive)). *See, e.g.,* Committee of Wise Men on the Regulation of European Securities Markets, 'Final Report' (2001) 15 February (The Lamfalussy Report).

PART TWO

EXPLORING THE DISCREPANCY BETWEEN THE OBJECTIVES OF THE GREEK CORPORATE GOVERNANCE STANDARDS, COMPLIANCE, AND ACTUAL GOVERNANCE EFFICIENCY

CHAPTER 3

THE DISCUSSION OF THE GREEK CORPORATE GOVERNANCE FRAMEWORK

1. INTRODUCTORY REMARKS

The Purposes of this Chapter

The objectives of this chapter are four. First is to describe the Greek corporate governance attributes applying the contextualised approach, as in the previous chapter. More particularly, the chapter seeks to explain the specific patterns of Greek corporate governance arrangements and to highlight that due to situational variables the Greek corporate governance system, though it follows closely the models of other jurisdictions, yet it is a, distinct, 'hybrid rule-based' system.

Second is to further understand the legal and economic assumptions that explain the shape of the existing corporate governance framework. More particularly, alongside the progress of the Greek capital market law and securities legislation, the development of the Greek corporate governance principles has been witnessed. To that end, the chapter sketches the development of the Greek capital market law given that, as in other jurisdictions, likewise in Greece, capital market law and securities legislation has underpinned many of the most fundamental corporate governance principles.

Third is to attest the tendency of the Greek regulator to legislate by producing large volumes of legal texts on corporate governance issues, therefore creating an overly bureaucratic legal framework. This is particularly revealed by reviewing the legislative means by which the OECD Corporate Governance Principles were introduced in the Greek legal order. In addition, a key characteristic that is demonstrated throughout the following analysis is that the regulator closely follows the developments in the EU legislation. This is confirmed by describing all corporate governance obligations, the enactment of which is more often than not part of the incorporation process of the European legislation (and recommendations) into the Greek legal order. In this setup, the main proposition at the core of this thesis explored is that the current Greek corporate governance system, which entails a large amount of rules, contains rules that overlap with other legislation. Such overlaps and the inherently rigid civil law system are reckoned to create an overly bureaucratic legal framework.

Therefore, the fourth objective of the present analysis is to provide the building block for the analysis that follows in the next chapter, in an attempt to show that the current, and rather rich (in terms of volumes of legal documents), legal framework governing the corporate governance practices of Greek corporations (mainly listed firms) is overly bureaucratic and rigid. In turn, obstacles are created in achieving satisfactory levels of compliance, dramatically undermining the Greek corporate governance system's efficiency.

The Structure of this Chapter

The chapter is structured as follows. First, upon a more contextualised approach to the principal agent theory, as analysed in the previous chapter, it is concluded that the Greek system is not a wholesale construction of the most dominant systems (such as for instance the Anglo-Saxon or the Continental European systems). Rather, as it appears from a closer examination that the Greek model is a distinct one, significantly influenced by international paradigms, yet with major adaptations to domestic attributes.

Second, the review of the structure of the Greek capital and securities market offers valuable insight explaining the current formation of the corporate governance framework. This is so given that the Greek capital market law and securities legislation has provided the legal background for defining numerous corporate governance principles, especially the introduction of the Corporate Governance Law in 2002, which applies to all listed companies (including those firms that are in the process of being listed and to some certain extent to non listed firms by way of analogy).

Third, prior to briefly describing the corporate governance rules, the evolution of those rules is presented, aiming to show the corporate governance activism in the Greek market started after the year 1999. At that time, although at a global level such activism was considerable, an event of significant national importance occurred. The slowdown of the Athens Stock Exchange (ASE) revealed a number of irregularities that demanded prompt corrective actions.

Fourth, the study goes through the main provisions of the Corporate Governance Law of 2002, focusing on its interpretational ambiguities, its drafting generalities, and the unnecessary burden that it creates to listed firms. The objective is to establish the regulatory overlaps, the tendency of the regulator to legislate on corporate governance matters (hard law approach), and the existence of a poorly drafted law. Such characteristics are reckoned to create an overly bureaucratic legal framework and to reasonably determine the level of efficiency of the Greek corporate governance system.

Fifth, the pervasive influence of the OECD and most importantly of the EU regulations has been recognised as an important parameter for the development of the existing Greek corporate governance universe. Therefore, the incorporation of those rules into the Greek legal order, more often than not by the enactment of specific legislation, is extensively discussed, in an attempt to explain three things. One, that these two sources of law are significant for determining the Greek corporate governance universe. Two, it is the fact that these two sources of law possess a prominent position in the Greek legal order since they are binding legal principles usually introduced by the enactment of legislation. Three, it is the tendency of the Greek regulator to legislate on corporate governance matters, therefore confirming the nature of the Greek rules-based corporate governance system.

2. GREECE: DEFINING THE CORPORATE GOVERNANCE SITUATIONAL VARIABLES

Introduction

Upon a more contextualised approach to the principal agent theory, as discussed in the previous chapter, it is established that the diversity of corporate arrangements, specific corporate governance patterns, and approaches are mediated by their fit or alignment with situational variables arising in diverse organisational, corporate, and legal environments. Therefore, the shape of the specific corporate governance model in each country is a compilation of those situational variables.

The main objective of this part is to understand the Greek corporate governance patterns, the specific agency concerns that are associated with certain disciplinary mechanisms, the similarities to, and differences from other systems. The discussion of the Greek situational variables in comparison with variables of other jurisdictions will help explain why corporate governance systems differ across countries.

Specifically, the differences in the corporate background and environment are due to, *inter alia*, different formations of corporations; the different practices in securing financing; the different capital market laws; the variable level of protection of shareholders; the different degree of participation of employees in the decision making process; the regulatory response to correct problematic situations, etc.

In the analysis that follows the method of presentation is not merely a descriptive but comparative as well. Such comparative method is used to describe those situational variables as to Greece compared with other jurisdictions (such as for instance USA, UK, Germany, and Japan). Therefore, it is shown the ways in which the Greek civil and corporate governance system was influenced by other international practices, confirming that the Greek corporate governance model entails elements from the prevailing international paradigms, yet with significant adaptations to domestic attributes and some points that it offers its own original solutions or formulations.

The following important considerations are highlighted. First, that in relation to ownership structure, the Greek corporate governance framework most resembles the Japanese family firms' model. Second, with respect to the legal origin it is closer to the German system. Third, it very much follows the spirit and the letter of the OECD best practices and recommendations. Fourth, it strongly considers the UK codes approach based on the 'comply or explain' principles. Fifth, at the same time, the Greek corporate governance model reveals a tendency to look to the US hard law approach to regulation. Sixth, that in conjunction with all the above the impact of the EC law in determining the nature of the corporate governance system is pervasive.

Greek Corporate Governance Attributes under the International Spotlight

In light of the key predicates upon which the corporate governance models are differentiated (i.e. ownership structure, legal tradition, the source of financing, disciplining mechanisms, specific social and political expectations, the differing paths of economic development, and the political history and culture within which public firms are organised and operate), an attempt to approach the Greek corporate governance system from a single point of view (e.g. the Anglo-Saxon corporate governance pattern) is not possible. This is due to the fact that the Greek corporate governance system accommodates some of the key predicates of the most dominant corporate governance practices, namely the Anglo-Saxon, the German, and the Japanese ones.

Beyond the typical US and UK corporate governance systems, important empirical work has revealed that the world wide corporate governance landscape has a single monolithic feature: control of publicly traded corporations is typically lodged in a single individual, family, or group.[297] Thereby on the grounds of concentrated ownership structure, the Anglo Saxon practices are the less dominant ones but yet the most cited reference point in the corporate governance literature.[298]

Legal Tradition: Civil Law Determined by the European Law

To start with, Greek law belongs to the category of civil law and is mainly influenced by the French and the German standards. Civil law's main feature is that only legislative enactments (rather than judicial precedents, or the works of legal scholars as is the case in common law systems) are considered legally binding. However, in reality, Greek courts do pay attention to, and are informed of previous decisions, especially from higher courts (and

[297] *See, e.g.*, Gilson, R.J., 'Controlling Shareholders and Corporate Governance: Complicating the Comparative Taxonomy' (2005) ECGI, Law Working Paper 49. In addition, La Porta, Lopez-de-Silanes and Shleifer present data on ownership structures of large firms in 27 wealthy economies and find that relatively few of those firms are widely held, in contrast with the Berle-Means image of ownership of the modern corporation, *vis-à-vis* US and UK firms. *See, e.g.*, La Porta, R., F. Lopez-de-Silanes, and A. Shleifer, 'Corporate Ownership around the World' (1999) 54 (2) J Fin 471.
[298] Compared with most of the rest of the world, the corporate arrangements in the US and the UK remain an oddity. According to the OECD, more than 75% of all registered companies in the industrialised world are family business –and not just small and medium sized ones. Yet, such structures are essentially unheard of in the US and the UK. *See, e.g.*, Becht, M., P. Betts, and R. Morck, 'The Complex Evolution of Family Affairs' *Financial Times* (3 February 2003).

especially those of the 'Areios Pagos' -the Supreme Civil and Criminal Court). Usually, courts only seldom depart from prior established practice reflected by a series of decisions. In a similar manner, the works of legal scholars have the potential of influencing both the legislators in enacting the law and the courts in interpreting it.[299]

More particularly, from a comparative legal perspective, the Greek civil law belongs to the distinct group of German civil law (along with Germany, Austria, Croatia, Switzerland, Portugal, Turkey, Japan, South Korea and the republic of China).[300] For the most part, Greek law is codified and, unlike Anglo-American common law, only enacted laws either in the form of codes or other statutes are the sources of law in addition to custom and international law.[301]

Additionally, in Greece, as in all member countries of the EU, many aspects of the national legal system are exposed to rapidly accelerating change due to the pervasive impact of the EC law. Greece became the tenth member of the then European Economic Communities (now the European Union) on January 1, 1981.[302] As a result, both the rules provided for by the Treaty of Rome establishing the EU and the directives or regulations of the Council or the Commission play an important role in Greek law, either becoming an

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[299] *See, e.g.,* Christodoulou, D. P., 'Introduction to the Greek Legal System' Jurist Legal Intelligence.

[300] It is worth noting that comparative scholars have also distinguished two more civil law groups. One, it is the French civil law, where France, the Benelux countries, Italy, Spain and former colonies of those countries belong. Two, it is the Scandinavian civil law countries, where Denmark, Norway, Sweden, Finland and Iceland belong. In the context of the literature on comparative law, a book written by Kerameus, K. D., and P. J. Kozyris *Introduction to Greek Law* (Deventer / Athens: Kluwer and Sakkoulas 1988) reflects the first coherent presentation of the Greek legal system written in English. The reader can be familiarised with the history, methods, and sources, as well as much of the substance of the country's law, which exceed the scope of the present thesis.

[301] *See, e.g.,* Christodoulou, D. P., 'Introduction to the Greek Legal System' Jurist Legal Intelligence.

[302] For more information on Greece's EU membership, visit http://europa.eu/abc/european_countries/eu_members/greece/index_en.htm

integral part of the Greek legal system or influencing it towards the goal of harmonization of the law of all member states.

Concentration of Ownership: the Family Firms

The Greek corporate conditions crystallise family firms as the most dominant type of organisational structure. As aforementioned, according to studies on family firms' sustainability;[303] the family characteristics of the Greek firms seem to be maintained in the first generation life-cycle of the firm. Later on, as the family firm evolves, the corporate state of affairs are those of concentrated ownership, with members of the founding family to still possess key managerial positions, yet with no absolute controlling rights, and outside directors to obtain significant role.

In terms of ownership structure, a typical attribute of the Greek capital market is that the majority of large corporations are controlled by handful of families. According to data in La Porta, Lopez-de-Silanes, and Shleifer, 65% of the 20 largest Greek firms are controlled by a few wealthy families, while 30% are state controlled and only 5% are widely held with no controlling shareholders.[304]

Although most Greek corporations are controlled by wealthy families, this is very unusual for most great American and British corporations.[305] More particularly, the US corporate finance was historically characterised by diffuse ownership among a large number of outside investors, which corresponds the

[303] *See, e.g.,* Cadbury Sir, A., 'Family Firms and their Governance: Creating tomorrow's Company from Today's' (2000) Egon Zehnder International.
[304] *See, e.g.,* La Porta, R., F. Lopez-de-Silanes, and A. Shleifer, 'Corporate Ownership around the World' (1999) 54 (2) J Fin 471, 493.
[305] By contrast, in the US counterparties the data reveals 80% widely held firms, which rise to 90% in the UK firms. *Id.*

Berle and Means description of the separation of ownership and control.[306] Hence, the outside investors did not have any intermediate role in the separation of ownership and control. Against this background, the main corporate governance dilemmas (e.g. the protection of the interests of shareholders) explain the different approaches and corporate governance mechanisms and regulations employed to address them.[307]

By contrast to the US and UK corporate governance model, the Greek listed firms cannot be considered as having a diffuse ownership structure. The dispersion is rather low, with a tendency to become even lower.[308] More particularly, dispersion is now 35.70% when shareholders that own less than 1% are taken into account. This figure rises to 47.22% when shareholders that own at least 5% of outstanding shares are taken into account.[309]

Such pattern of ownership concentration is also explained by the findings of the London Business School survey[310] for the Greek corporate practices to the extent that they find that family firms' governance (concentrated ownership) tends not to follow hard laws. Even if there are certain rules and principles, those are mainly formatted by the existing corporate culture and they only cover certain activities of the firm. The presence of the owner in the management of the firm 'traditionally'

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306 *See, e.g.,* Berle, A., and G. Means *The Modern Corporation and Private Property* (The Macmillan Company, New York 1932).
307 *See, e.g.,* Roe, M. J., 'A Political Theory of American Corporate Finance' (1991) 91 (1) Colum L Rev 10, 17; and Roe, M. J., 'Political and Legal Restraints on Ownership and Control of Public Companies' (1990) 27 (1) J Fin Econ 7.
308 Cf. HCMC, 'Diffused Ownership in the Greek Listed Firms' (in Greek) (2001) December; and HCMC, 'Diffused Ownership in the Greek Listed Firms' (in Greek) (2001) June.
309 *See, e.g.,* Kapopoulos, P., and S. Lazaretou, 'Corporate Ownership Structure and Firm Performance: Evidence from Greek Firms' (2006) Bank of Greece, Working Paper 37; and HCMC, 'Diffused Ownership in the Greek Listed Firms' (in Greek) (2001) June.
310 *See, e.g.,* London Business School, *'Corporate Governance for Corporate Sustainability: The Greek Reality, 1945-2000'* (in Greek) (2003) Greek Alumni Association (Kantor; Genesis Pharma SA).

incorporates the whole corporate governance framework.[311] The owners-managers of those firms exercise their power to promote and satisfy their interests, usually coupled with an unwillingness to surrender part of their control rights and power in the sake of 'good governance practices'.[312]

As the main attribute of the Greek family-owned firms is the entrenchment of the owners-managers, the initial negative approach towards the implementation of corporate governance rules is explained. To the extent that a corporate governance system is described as a nexus of rules that impose specific obligations on the senior management of a corporation, it explains why in some cases, the senior management is not willing to comply with rules that could challenge their authority, position or power. Such obligations may appear for family firms as a strong reason for exiting or not joining stock exchanges.[313]

Finally, the Greek corporate governance model can be argued to be different from the Anglo-Saxon model, on the grounds of diversities in the business and legal context. The Greek business context crystallises listed companies as a small fraction of the total number of companies in the country. This contrasts sharply with the US and UK business context, where many

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[311] *See, e.g.,* London Business School, *'Corporate Governance for Corporate Sustainability: The Greek Reality, 1945-2000'* (in Greek) (2003) Greek Alumni Association (Kantor; Genesis Pharma SA).

[312] *See, e.g.,* Mouzoulas, S., *Law 3016/2002 on Corporate Governance: Article by Article Analysis - Evaluation from Institutional Investors' Perspective* (in Greek) (Sakkoulas Publications, Athens, 2003), at 6.

[313] According to the LBS survey examining the conduct of family firms in the Greek capital market concluded that for the period 1945 to 2000, there was a steady decline of the number of family firms that were present in the Top 100 of firms (according to total assets). While in 1945, 80 of the firms were family owned, in 2000 this number declined to 15. Evidently, the number of companies with low corporate governance standards (i.e. family firms) declines compared to the number of other listed companies in the Top 100 companies. *See, e.g.,* London Business School, *'Corporate Governance for Corporate Sustainability: The Greek Reality, 1945-2000'* (in Greek) (2003) Greek Alumni Association (Kantor; Genesis Pharma SA), at 21.

companies are listed, and their shares are publicly traded, resulting in little personal contact with their shareholders.

External Financing

In terms of external finance, the Greek corporate affairs, where family firms are the prevailing form of organisation, although in the first stages of the corporations' life no external finance is sought (either from bank loans or from stock exchange), yet, in the course of the firms' development and expansion, there is a fairly split trend, with some corporations to tend to seek external finance from banks and with some others from the securities market. In practice, as far as family firms are concerned, bank finance is sought to a greater extent, whereas larger corporations (including also ex family firms that have been transformed) usually list their share in the stock exchange.

In the UK, given that corporations in general are not dependent on bank financing but they rather seek financing through securities, thereby control of most public companies is in the public domain. Hostile takeovers are a phenomenon largely observed in the US and the UK.[314]

Regulatory Responses

Another distinguishing element of the Greek approach to corporate governance affairs relates mainly to the form of response to those concerns, whereby Greece adopts binding legislative means to address issues that traditionally are the subject of voluntary forms of action. This is testified by

[314] *See, e.g.,* Gilson, R.J., 'Controlling Shareholders and Corporate Governance: Complicating the Comparative Taxonomy' (2005) ECGI, Law Working Paper 49, at 2.

the review of the means by which the OECD Principles and other EU initiatives in the sphere of corporate governance were incorporated in the Greek legal order. In addition to the same direction point important reflections from the evolution of the Greek corporate governance principles, an analysis that also contributes to opening new avenues of comparative research and highlighting similarities, differences or convergence tendencies.

The Greek approach resembles more the US rule-based practice and contrasts with the UK one where a 'principles-based' approach is employed to corporate governance through the implementation of 'best practices' guidelines in combination with mandatory explanation as to the extent of compliance with such guidelines and, where a firm's practices depart from that approach, to describe the reasons for that deviation.[315] However, the Greek paradox is that although there is a rules-based corporate governance system, it is also suggested that an informal establishment be made of the possibility to 'comply or explain' non compliance, similar to the UK practice and other European countries.[316]

[315] *See, e.g.,* Weil, Gotshal and Manges LLP, 'Comparative Study of Corporate Governance Codes Relevant to the European Union and Member States' (2002) Final Report & Annexes I-III' (January).

[316] According to the findings of the 2006 Corporate Governance Survey, which reflect a similar trend in the 2005 Corporate Governance Survey, the vast majority of the Greek corporations do not make use of the possibility to explain the reasons for non compliance with corporate governance rules. *See, e.g.,* Grant Thornton and Athens University of Economics and Business, '*2006 Corporate Governance Survey*' (in Greek) (2006), at 8; and Grant Thornton and Athens University of Economics and Business, '*2005 Corporate Governance Survey*', 2005, at 8. Such practice of Greek corporations is mainly explained on the grounds that it is provided for by the Mertzanis Recommendations and not by the binding provisions of the Corporate Governance Law of 2002. On the contrary, there are very positive results on the level of explanation given by UK companies, who do not fully comply with the provisions of the Combined Code. In 2006, 96% (90%, in 2005) of the companies provided at least some explanation as to the reasons for non compliance. *See, e.g.,* Grant Thornton (UK), Risk Management Services, *'Fourth FTSE 350 Corporate Governance Review: Highlighting Trends in Compliance'* (2005), at 7; and Grant Thornton (UK), Risk Management Services, *'Fifth FTSE 350 Corporate Governance Review 2006: Highlighting Trends in Compliance'* (2006), at 9.

The adoption of this approach means that the recommendations contained in the Corporate Governance Codes are associated with the possibility of listed corporations to justify possible behaviour divergence from that implied by the recommendations.[317]

Furthermore, the fact that the Greek legislator prefers to enact a binding legislative document to enforce corporate governance rules does not necessarily reflect the recognition of the importance of corporate governance in the Greek capital markets but it may also reflect the pressure exercised on the Greek legislator to deal with intense capital market problems. Against such pressure, drafting weaknesses were the reason for the amendment of the Corporate Governance Law of 2002, soon after its enactment, by the Law 3091/2002.[318]

In addition, although the tendency of the Greek regulator to legislate on corporate governance matters leads to inflexible state of legal affairs, seen in isolation might not be reckoned as problematic, yet in the specific context of the Greek market an important observation can be made. The effects of such situation are, *inter alia*, that Greek corporations are facing complexities and difficulties in adapting to regulations, explaining in turn the moderate levels of compliance, as is shown in the next chapter.

Overall, debates have emerged over the appropriateness of different policy approaches based on hard law or regulation that draws upon soft law, such as codes based on comply or explain principles. The hard law approach to regulation (e.g. US and Greek approach) seeks to strengthen corporate

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[317] *See, e.g.,* Committee on Corporate Governance in Greece (under the coordination of the HCMC) 'Principles on Corporate Governance in Greece: Recommendations for its Competitive Transformation' (The Mertzanis Report) 1999 Athens, Greece, at 7.

[318] Hellenic Law 3091/2002 *'on Simplifications and Improvements in the Taxation of Income and Capital and Other Provisions'*, Government Gazette A330/24.12.2002.

governance through legal rules that cover all companies operating in a particular jurisdiction. Such an approach mandates high minimum standards and failure to meet these results in sever legal penalties. Soft law, such as the UK Combined Code, is based on an alternative approach of comply or explain principles.[319] This approach has been criticized for its weaker degree of enforcement and inability to mandate uniform minimum standards, but also has potential benefits in dealing with costs and contingencies.[320]

On the contrary, the mix of soft law and hard law approaches to corporate governance regulation is to a certain extent beneficial for firms because it provides them with flexibility to adapt or mix various corporate governance practices. Such option can help firms to tailor corporate governance to diverse business and organisational variables, provided that firms are corporate governance conscious. Overall the trade-offs involved in each regulatory response can be better understood by analysing the implementation effects.[321] As to Greece, these are analysed in more detail in the following chapter.

Shareholders' and Employees' Role in the Decision Making Process

The main legal text for the operation of Greek companies (e.g. Law 2190/1920,[322] as codified) sets the main principles for two important internal institutional mechanisms of those companies: (i) the General Meeting of Shareholders, and (ii) the formation and operation of the Boards of Directors.

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[319] *See, e.g.*, Aguilera, R. V., I. Filatotchev, H. Gospel, and G. Jackson, 'An Organisational Approach to Comparative Corporate Governance: Costs, Contingencies, and Complementarities' (2008) Organisation Sciences, *forthcoming*, at 31.
[320] *Id.* at 32.
[321] *Id.* at 33.
[322] *See, e.g.*, Hellenic Law 2190/1920 *on Public Limited Liability Companies* (sociétés anonymes), Official Government Gazette A37, as codified.

The General Meeting of the Shareholders is the 'supreme' decision-making organ of the company[323] and has the right to decide on all matters concerning key areas of the corporations' activities (e.g. make amendments to the company's statutes; appoint board members; appoint statutory auditors; approve the company's annual accounts and dividends; and distribute the annual profits). Shareholders exercise their rights through the shareholder meeting, which must be called at least once a year and shareholders must be notified, either in writing or by email, at least 20 days prior to any such meeting. The shareholders' right of vote in the general meeting corresponds to the shares they possess.

In more specific terms, in cases that the majority of controlling ownership is not assumed by large shareholders or families, alliances among shareholders are made quite often, ensuring in this way that certain classes of shareholders will have significant control rights. In the case of big conglomerates, the management of firms is directly controlled by large shareholders, while the minority shareholders are considerably secluded and weak to raise any objections, even when the latter participate in the Board of Directors.[324] Usually, the minority of shareholders is happy with receiving the minimum information, either at a Board of Director's level or at a level of the General Shareholders Meeting.

The Greek corporate structure more closely resembles the German and Japanese one in terms of the role of employees in the decision making process. Such role is secured by EU rules, according to which certain

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[323] *See, e.g.*, Hellenic Law 2190/1920 *on Public Limited Liability Companies* (sociétés anonymes), Official Government Gazette A37, as codified, Article 33.

[324] *See, e.g.*, Mouzoulas, S., *Law 3016/2002 on Corporate Governance: Article by Article Analysis - Evaluation from Institutional Investors' Perspective* (in Greek) (Sakkoulas Publications, Athens, 2003), at 9.

procedures have been developed to ensure fair participation of employees in the decision-making organs and mechanisms of corporations. In specific cases, employees or their representatives, not only participate in the decision-making mechanisms but they also have rights of information, negotiation and even of co-decision. The Greek legislation, in compliance with the EU demands, stipulates that 1/3 of the employees must participate in the Board of Directors or in the General Meeting responsible for the Social Control.[325]

It follows that syndicalism (or trade unionism) in Greece is quite developed with wide ranging role in promoting or blocking laws and regulations.[326] Syndicalism has gained over the time much power enabling the promotion of views and actions simply favourable and beneficial to employees' rights.[327] However, according to data for the year 2000, it is recorded that the increased power of syndicalism in Greece appears to decline, finding an increasing decline of the role of trade unions with 65.6% of employees not to be members of any trade union.[328] Notwithstanding that the 60.6% of the participants expressed their opinion that trade union are the most effective means through which employees can promote their interests, the decline of the power of trade unions reflects a new era for corporate governance reforms in Greece.[329]

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[325] The development of work councils was envisaged by Article 1 of the Hellenic Law 1767/1988 *Work Councils and Other Labour Provisions*, Official Government Gazette A63/ 06.04.1988, as last amended by Law 2941/2001 on Simplification of Procedures for Setting up Corporations (Official Government Gazette A201/ 12.09.2001).

[326] Increased government intervention and interference of political parties in the structure and the formation of their overall stance is typical of the Greek trade unions. For a brief historical evolution and explanation of today's trade unions in Greece, *see, e.g.*, Kouzis, G., 'Trade Unionism in Greece' (in Greek) Enimerosi, General Union of Employees in Greece (2005) 122.

[327] *See, e.g.*, Katsoridas, D., 'Trade Unions and Labour' (in Greek) Enimerosi, General Union of Employees in Greece (2001) 69.

[328] *Id.*

[329] *Id.*

In general, Greek institutional investors do not have much power and this is mainly due to their focus on short-term investments rather than on long-term commitments. In Greece, institutional investors usually follow a passive voting for management and they rarely provide sufficient information for their investment policy to beneficiaries.[330]

On the contrary it is typical that in a large American public firm, dispersed shareholders are very distant from the decision making process (either physically or due to lack of financial education). Despite the recent active role of US institutional investors, the US corporate governance is strongly characterised by generally passive shareholders, compared to German and Japanese investors.[331] Such passivity of American shareholders is mainly explained on the American structure of corporate governance, which largely focuses power in management, particularly in the CEO. For this reason, American shareholders are relatively powerless to affect management decisions[332] and monitoring generally occurs ex post rather than ex ante, assuming a more evaluative than proactive nature.[333] In sharp contrast, managers of Japanese firms sacrifice control and flexibility for the safety and security of a main bank relationship.[334]

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[330] *See, e.g.*, Mouzoulas, S., *Law 3016/2002 on Corporate Governance: Article by Article Analysis - Evaluation from Institutional Investors' Perspective* (in Greek) (Sakkoulas Publications, Athens, 2003), at 7.

[331] For a criticism on the actual role of institutional investors, *see, e.g.*, Millstein, I. M., 'The Board – Governing Beyond Where the Law Ends' (address to the ICGN 2006 Annual Conference, Washington DC, 5 July 2006).

[332] *See, e.g.*, Miller, G. P., and J. R. Macey, 'Corporate Governance and Commercial Banking: a Comparative Examination of Germany, Japan and the United States' (1995) 48 (1) Stan L Rev 73, 81.

[333] *See, e.g.*, Boot, A. W. A., and J. R. Macey, 'Monitoring Corporate Performance: the Role of Objectivity, Proximity and Adaptability in Corporate Governance' (2004) 89 (2) Cornell L R 353, 358.

[334] *See, e.g.*, Miller, G. P., and J. R. Macey, 'Corporate Governance and Commercial Banking: a Comparative Examination of Germany, Japan and the United States' (1995) 48 (1) Stan L Rev 73, 81.

Admittedly, labour participation is almost unknown to company law in the UK, in sharp contrast with the system of employee codetermination in Germany.[335]

Stakeholders' and Institutional Investors' Role

Pension funds and banks do not have a pivotal role in the corporate governance framework of the Greek capital market, compared to the US and the UK practices. The market itself appears to be inefficient and its contribution in the transformation and improvement of the operations of corporations -particularly with take over bids as an important mechanism, which could eventually lead in the change of the leadership composition- seems to be quite limited.[336]

Such differences of institutional investors' voice and influence on issues regarding the regulation and treatment of listed companies are explained by historical roots. For instance, despite the general and long standing US tendency against concentration of power to financial institutions[337] and other institutional investors, only the state pension unions

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335 In a historical context, English company law was unaffected by employee concerns especially after the failure of the Bullock Committee's proposal on labour representation at the board level in the mid '70s, *see, e.g.,* Hopt, K. J., and P. C. Leyens, 'Board Models in Europe: Recent Developments of Internal Corporate Governance Structures in Germany, the United Kingdom, France and Italy' (2004) ECGI, Law Working Paper 18, at 14. On the Bullock proposals *see, e.g.,* Davies, P. L., 'A Note on Labour and Corporate Governance in the UK' in K. J. Hopt, H. Kanda, M. J. Roe, E. Wymeersch and S. Prigge (eds.), *Comparative Corporate Governance: the State of the Art and Emerging Research* (Clarendon Press, Oxford 1998) at 373-386.

336 *See, e.g.,* Mouzoulas, S., *Law 3016/2002 on Corporate Governance: Article by Article Analysis - Evaluation from Institutional Investors' Perspective* (in Greek) (Sakkoulas Publications, Athens, 2003), at 8.

337 This American result is explained on America's politics of financial fragmentation, rooted in federalism, populism and interest group pressures reducing the power of American financial institutions, contributing heavily to the rise of the 'Berle-Means corporation'. *See, e.g.,* Roe, M.J., 'Some Differences in Corporate Governance in Germany, Japan and America' (1993) 102 (8) Yale L J 1927, 1929. Also, *see, e.g.,* Roe, M.J., 'A Political Theory of American Corporate Finance' (1991) 91 (1) Colum L Rev 10, 17; and Roe, M. J., 'Political

had a governance role.[338] Starting from 1987, in the US, institutional investors -pension funds in particular- deviated from their prior role as passive investors by submitting proxy proposals focusing largely on corporate governance issues and therefore the decision when to reorganize a company.[339]

Accordingly, the UK institutional investors own approximately 70% of the equity in the country's public corporations.[340] Still, an individual financial institution is unlikely to control more than 5% of the equity in any one firm.[341] However, the American equities markets are less institutionally dominated than the UK stock market.[342] It follows that the premise that institutional investors may be highly effective external monitors is intuitively appealing in the UK.[343] Additionally, although in the US coordinated shareholder activism is rare, this practice contrasts sharply with UK, where coordinated institutional investors often approach a company jointly to increase that influence.[344]

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and Legal Restraints on Ownership and Control of Public Companies' (1990) 27 (1) J Fin Econ 7.

[338] Shareholder activism is particularly strong in US (and the UK). However, American institutions remain far more hemmed in by legal constraints than their British counterparties. *See, e.g.*, Black, B. S., 'Shareholder Activism and Corporate Governance in the United States' in P. Newman (ed.), *New Palgrave Dictionary of Economics and the Law* (Stockton Press, New York 1998), Vol. 3, at 459, further citing Black, B. S., and J. Coffee, 'Hail Britannia?: Institutional Investor Behaviour Under Limited Regulation' (1994) 92 (7) Mich L R 1997; and Roe, M.J., 'Some Differences in Corporate Governance in Germany, Japan and America' (1993) 102 (8) Yale L J 1927.

[339] *See, e.g.*, Friedman, B., 'Economic Implications of Changing Share Ownership' (1996) 22 (3) J Portfolio M 59, 60.

[340] *See, e.g.*, Steele, M., 'Time for Investors to Come in from the Cold' *Financial Times* (19 May 2005).

[341] *See, e.g.*, Department of Trade and Industry – (DTI), *'Modern Company Law for a Competitive Economy: Developing the Framework'* (2000) URN 00/656, at paragraph 11.26.

[342] *See, e.g.*, Black, B. S., and J. Coffee, 'Hail Britannia?: Institutional Investor Behaviour Under Limited Regulation' (1994) 92 (7) Mich L R 1997, 2002.

[343] On the role of financial institutions in corporate governance in the UK, *see, e.g.*, Black, B. S., and J. Coffee, 'Hail Britannia?: Institutional Investor Behaviour Under Limited Regulation' (1994) 92 (7) Mich L R 1997, 2002; and Davies, P. L., 'A Note on Labour and Corporate Governance in the UK' in K. J. Hopt, H. Kanda, M. J. Roe, E. Wymeersch and S. Prigge (eds.), *Comparative Corporate Governance: the State of the Art and Emerging Research* (Clarendon Press, Oxford 1998) at 373-386.

[344] *See, e.g.*, Black, B. S., and J. Coffee, 'Hail Britannia?: Institutional Investor Behaviour Under Limited Regulation' (1994) 92 (7) Mich L R 1997.

The Board of Directors

In principle, the one-tier system of Greek board of directors' structure is opposed to the so-called dual or two-tier system, where there is clear distinction between managing and supervisory directors (e.g. Germany). In such structures shareholders directly elect the directors through the General Meeting of Shareholders (i.e. monistic system). More particularly, both the management and the supervision are exercised by the managing Board of Directors[345] but generally delegate day-to-day management to hired executive managers and it represents the company. It is made up of at least three members and is required to meet at least once a month. The Board of Directors has significant discretionary power and broad authority to decide on every matter related with the management of the company; the administration of its property; and generally with the implementation of the company's objectives. Yet, company's bylaws may impose stricter limits and guidelines. The relationship between the directors and the company, as a legal entity, is an organic one with directors to act as an arm-organ of the company.[346]

The liability of the managing director, otherwise the Chief Executive Officer (CEO), is much stricter than that of other senior managers of board members. However, with regard to the separation of the roles of CEO and Chairman of the Board, the family origins of Greek corporations can explain the trend of combining these two roles into a single person. This is also reflected by the findings of the 2005 and the 2006 Corporate Governance Surveys, revealing that although there is a small decline of the companies that still combine these two positions, the remaining majority of the companies do

[345] Article 22, paragraph 1, Hellenic Law 2190/1920 *on Public Limited Liability Companies* (sociétés anonymes), Official Government Gazette A37, as codified.
[346] 70-71AK (Hellenic Civil Code, 23 February 1946).

not separate those roles. Specifically, in 2005, 38.5% of the companies appointed different person for the position of the CEO and Chairman, and in 2006 this statistic was slightly improved to 42.4%.[347] By contrast, fewer than 25% of companies in the US and just over 50% of companies in Japan separate the roles of chairman and CEO. A high proportion of companies with separate chair and chief executives within a unitary board structure are in the UK, with over 92%.[348]

Additionally, the same legal origins explain the practice of the Chairman having executive powers. Although, according to 2006 data, there is a decline in that practice with 76.6% of the corporations allowing the Chairman to have executive powers (in 2005, 86.4%), still the Greek corporations are lagging dramatically behind the 7% of the UK corporations that the Chairman of the Board has executive powers.[349]

Independent Directors

The USA presents high percentages of independent directors on the board. As aforementioned, the independent oversight of board decision-making is integral to the effective functioning of a company, maintaining accountability and transparency. In the wake of the high profile scandals of

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[347] *See, e.g.,* Grant Thornton and Athens University of Economics and Business, '*2005 Corporate Governance Survey*', (2005), at 12; and Grant Thornton and Athens University of Economics and Business, '*2006 Corporate Governance Survey*' (in Greek) (2006), at 12.

[348] Specifically, according to the findings of the Fourth and Fifth FTSE 350 Corporate Governance Review, 93.1% and 92.7% of the UK companies separated the two roles, in 2005 and 2006, respectively. Essentially, this pattern of separating the roles of CEO / Chairman in the UK companies originates from the recommendation A.2 of the Combined Code, which states that '*there should be a clear division of responsibilities at the head of the company between the running of the board and the executive responsibility for running of the company's business.*' *See, e.g.,* Grant Thornton (UK), Risk Management Services, '*Fourth FTSE 350 Corporate Governance Review: Highlighting Trends in Compliance*' (2005), at 11; and Grant Thornton (UK), Risk Management Services, '*Fifth FTSE 350 Corporate Governance Review 2006: Highlighting Trends in Compliance*' (2006), at 14.

[349] *See, e.g.,* Grant Thornton and Athens University of Economics and Business, '*2005 Corporate Governance Survey*', (2005), at 12; and Grant Thornton and Athens University of Economics and Business, '*2006 Corporate Governance Survey*' (in Greek) (2006), at 12.

WorldCom and Enron, the US was quick to implement reform including the Sarbanes Oxley Act and the revised New York Stock Exchange (NYSE) listing requirements. A key focus was independence on the board.

On the other side, a stricter UK approach is adopted with regard to director independence. Section 301 of the Sarbanes Oxley Act considers independent directors those who are not employed full time by the firm and who do not receive other compensation from the firm.[350] The Sarbanes Oxley Act does not address director option plans and thus it does not consider whether director options may compromise the independence of non-executive directors. By contrast, the Higgs Report[351] and the revised Combined Code[352] employ a somehow stricter and more restrictive definition of director's independence. Although, the UK definition of independence considers the US definition[353] to the extent that independence is precluded if the director receives compensation from the firm for services other than as a director, it goes a step further. It follows that the Higgs 'no-options' definition of independence considers that compensation outside the director's fee would compromise independence.[354]

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[350] *See, e.g.*, US House of Representatives, 'Public Company Accounting Reform and Investor Protection Act of 2002' (The Sarbanes-Oxley Act of 2002) Public Law No. 107-204, 116 Stat. 745 (30 July 2002).

[351] *See, e.g.*, Department of Trade and Industry – (DTI), '*Review of the Role and Effectiveness of Non-Executive Directors*' (2003) January (the Higgs Report).

[352] *See, e.g.*, Financial Reporting Council – (FRC), 'The Combined Code on Corporate Governance' (2003) July. Following a review of the implementation of the Combined Code in 2005, the FRC consulted on a small number of changes to the Code. These changes were incorporated in an updated version of the Code published in June 2006 (*See, e.g.*, Financial Reporting Council – (FRC), 'The Combined Code on Corporate Governance' (2006) June) (The revised Combined Code).

[353] Requiring a greater degree of independence on boards has been a central theme in the US corporate governance reform measures. The Sarbanes Oxley Act requires all members of the audit committee to be independent. Under the new NASDAQ listing rules and the new NYSE listing rules, a majority of the board must be independent. *See, e.g.*, Department of Trade and Industry – (DTI), '*Review of the Role and Effectiveness of Non-Executive Directors*' (2003) January (the Higgs Report).

[354] *See, e.g.*, Department of Trade and Industry – (DTI), '*Review of the Role and Effectiveness of Non-Executive Directors*' (2003) January (the Higgs Report).

In terms of the evolution of corporate governance, the Higgs Report was a timely opportunity to review the role and effectiveness of non executive directors, thereby further developing the UK framework of corporate governance with emphasis on the non-executive directors as the custodians of the governance process.[355] More particularly, the Higgs Report reflects on the quality of non-executive directors and on the boardroom climate, along with the behaviour necessary for their success. Its main findings are mainly concentrated on enhancing the competence and effectiveness of boards in promoting business prosperity.

When it comes to the specific context of the Greek market, a paradox is observed. On the one side, it is recognised that independent directors as disciplinary mechanism are vital, envisaged also in Articles 3 and 4 of the Corporate Governance Law of 2002,[356] but on account of the entrenchment of the owners-managers in the context of family firms their role is limited. From an agency perspective, the conflicts of interest do not usually arise between shareholders and managers but rather between large shareholders and external investors. In the cases of large shareholders, who control and influence the General Shareholding Meeting, the role of non executive members in the Board is limited. Such restricted role can be also explained on the fact that the appointment of independent non executive members on the Board of Directors is not welcome in family firms because that would mean that the family members would have to transfer part of their control rights and management power to handful of independent members. Therefore, although independent

[355] *See, e.g.,* Department of Trade and Industry – (DTI), '*Review of the Role and Effectiveness of Non-Executive Directors*' (2003) January (the Higgs Report).
[356] *See, e.g.,* Hellenic Law 3016/2002 *on Corporate Governance, Board Remuneration and Other Issues,* Official Government Gazette 110/ 17.05.2002, as amended by Law 3091/2002, (Official Government Gazette A330/ 24.12.2002).

directors are needed, family firms are reluctant to appoint them. Apparently, in such state of affairs, the focus should be on the duties and obligations of the members of the Board of Directors and especially of the shadow directors, who manage the company without typically to be eligible to participate in the Board.[357]

3. THE GREEK CAPITAL MARKET: DEVELOPMENT AND MAIN ATTRIBUTES

In further understanding the elements of the existing corporate governance framework, the focus of the analysis shifts to discuss the development of the Greek capital market. This is so given that as in other jurisdictions likewise in Greece the capital markets law and securities legislation has provided an important legal background for defining fundamental corporate governance principles. Alongside the progress of the Greek economy and the capital market law, the development of the Greek corporate governance structures has been observed.[358] Therefore, the economic history of Greece provides useful insight for the development of the country's capital market law and its corporate governance regime.

[357] *See, e.g.*, Hadjiemmanouil, C., 'Corporate Governance' (in Greek) (speech to the Institute of Democracy Konstantinos Karamanlis, April 2002) Working Paper Series 15.
[358] *See, e.g.*, Athanassiou, P., 'Recent Developments in Greek Capital Markets Law' (2005) 16 (4) EBLR 893, 900.

The Athens Stock Exchange (ASE)[359] that suffered until the mid-1990, performed spectacularly in the period of 1995-1999 (particularly, after January 1997 and until December 1999, when corrections of prices took place[360]). Such progress gained significant momentum when the Greek economy met the Maastricht criteria and Greece joined the Economic and Monetary Union (EMU) in 2001. Within this environment, the Greek economy sustained its high growth rate despite the slowdown in the global economy -which was aggravated after the terrorist attack in New York. During this period of positive economic performance, the market capitalization of the ASE grew fast with significantly increased numbers of

[359] The Athens Stock Exchange was founded in 1876 as a regulatory independent government agency, the forerunner of the equity securities market of the contemporary Athens Exchange (ATHEX). For a historical review of the 125 years of the operation and evolution of the ASE; presentation of all the basic economic, political and other factors, which contributed to its evolution and its current formation, *see, e.g.*, Athens Stock Exchange S.A., '1876-2001: the 125 Years of the Athens Stock Exchange' (2001). ASE's transformation process began in 1995 when the ASE became a state owned sociétés anonymes instead of the then self-regulated public law institution, operating under the supervision of the then Minister of Economy and Finance and the Hellenic Capital Market Commission (A joint stock company was established under the name 'Athens Stock Exchange S.A.'). The transformation of the ASE gained momentum in March 2000 with the establishment of the 'Hellenic Exchanges S.A.', which is the parent company of the ASE. Currently, the ASE consists of the following different markets: (i) the Main Market; (ii) the Parallel Market; and smaller markets such as (iii) the New Stock Exchange Market ('NEHA' established under the Law 2733/1999 *on Development of New Market in the ASE, General Amendments of the Capital Market, the Public Companies and Organizations, the Corinth Canal SA and Other Provisions'*, Official Government Gazette A155/ 30.07.1999, as last amended by Law 3152/2003, Official Government Gazette A152/ 19.06.2003, and it provides a less onerous listing and trading regime for the securities of innovative or high growth medium and small sized firms, which did not fulfill the listing requirements of the ASE's Main or Parallel market.); and (iv) the Greek Market of Emerging Capital Markets ('EAGAK'). *See, e.g.*, Athanassiou, P., 'Recent Developments in Greek Capital Markets Law' (2005) 16 (4) EBLR 893, 898. The main responsibilities of the ASE include, *inter alia*, the approval of the listing of new shares; the supervision of its members and its listed companies; the provision of assistance to the HCMC on matters of corporate governance, including the monitoring of acquisitions of significant stakes of listed companies and obligations under the exchange's rules of conduct; the coordination of the processes for conducting market transactions; the certification and appointment of brokers' representatives.

[360] *See, e.g.*, Doukas, P. G., *Corporate Governance, Securities, Stock Exchanges and Corporations' Evaluation* (in Greek) (I. Sideris Publications, Athens, 2002), at 66-67. The author also provides a range of explanations that lead mainly domestic investors to seize on the vast potentials for the expansion of the Greek securities markets at that time. (*See also id.* at 67-71).

listed companies and was also marked by the operation of the Athens Derivatives Exchange (ADEX)[361] in autumn 1999.[362]

In retrospect, the shallow Greek capital market and the usual practice of domestic investments to mainly be directed to the domestic shares and values, with foreign institutional investors to be the minority,[363] reflected important elements of the corporate landscape in Greece and excuses to some

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[361] The Law 2533/1997 *on Derivatives Exchange and Other Provisions*, Official Government Gazette A228/ 11.11.1997, as last amended by Law 3371/2005 (Official Government Gazette A178/ 14.07.2005) provides the necessary legal framework for the establishment of the formal and organized derivatives market in Greece. The ADEX and the Athens Derivatives Exchange Clearing House S.A (ADECH) are established for the organisation, operation and development of the market. The main purpose of ADEX is the organization and support of the transactions concluded in the derivatives market; the operation of the trading system in the derivatives market as well as any similar activity (Article 2, paragraph 2). ADECH's main purpose is to participate in the derivatives contracts conducted in ADEX; to clear transactions concluded in the derivatives exchange market or in other markets; to ensure compliance of the contracting parties with the obligations arising from derivative contracts; and to engage in any other related activity (Article 16, paragraph 2). In respect to the adherence to the rules and regulations of the capital market, the HCMC exercises control and supervision on ADEX's and ADECH's operation (Article 8, paragraph 1).

[362] *See, e.g.*, Tsipouri, L., and M. Xanthakis, 'Can Corporate Governance Be Rated? Ideas Based on the Greek Experience', (2004) 12 (1) CG 16, 17.

[363] The Foreign Direct Investments (FDI) flows remain low in comparison with the EU. FDI inwards as a percentage of gross fixed capital formation increased from 5.9 in 1985-1995 to 6.0 in 2001. However, in 2002 FDI inwards in proportion to Greece's gross fixed capital formation dropped sharply to 0.2. At the same time, the EU average increased from 5% in 1985-1995 to 22.5% in 2002. In general, Greece's inward FDI Performance Index is below the composite index for the EU countries. Interestingly, among the group of Mediterranean countries, Greece shows the second lowest level of estimated deterred FDI, in a range from 92-122%. *See, e.g.*, Spanos, L., 'Corporate Governance in Greece: Developments and Policy Implications' (2004) EconWPA. According to 2005 data from Eurostat, Greece takes the second lowest place in total FDI outflows for 2005. *See, e.g.*, Eurostat, 'Increased FDI Flows for the EU in 2005' (2006) 21 Economy and Finance (10 October 2006). Additionally, the current increased FDI outflow in Greece is mainly due to the fact that (i) the Dutch company Aramco sold all its shares that possessed from Motor Oil Holdings S.A.; and (ii) the major Greek banks, based on their strategy, expand their operations to the Balkans with the acquisition of Jubanka in Serbia & Montenegro by Alpha Bank (total FDI outflow of 152 million Euros); participation of Alpha Bank to the share capital increase of its subsidiary Alpha Bank Romania (total FDI outflow of 66 million Euros); and the acquisition from EFG Eurobank Ergasias S.A. of the Nationalna Stedionica Banka in Serbia & Montenegro. In general, the high levels of bureaucracy and the overall investment environment in Greece partially explain the low position of Greece in that regard. *See, e.g.*, Stergiou, L., 'Large FDI Outflows in 2005' (in Greek) *Kathimerini* (13 October 2006). In May 2006, although the acquisition from the Dubai Financial Group of the 31.5% of Marfin Financial Group, an FDI inflow of 392 million Euros, along with the participation of Societe General in the share capital increase of Geniki Bank and Credit Agricole to Commercial Bank of Greece, reflected the beginning of an era of increased FDI inflows, still the activities of Greek banks in the region of Balkans can ultimately correct such increase (e.g. in January, the National Bank of Greece participated in the share capital increase of Banca Romanesca S.A. in Romania; and in March, EFG Eurobank Ergasias S.A. acquired the 100% of Polska Bank in Poland). *See, e.g.*, Stergiou, L., '800 Million Euros FDI Inflows in Telecommunications and Banks in 2006' (in Greek) *Kathimerini* (13 October 2006).

certain extent the limited (at least at that time) role of corporate governance principles. In view of the lack of the foreign element, the Greek capital market, while theoretically open to foreign investments, does not attract international investments.[364] Therefore, the alternatives for (domestic) investors were limited; helping in this way the championing of certain conditions and practices, not necessarily oriented by good corporate governance principles.

However, certain signs of change have been documented particularly after the Olympic Games of 2004, when the Greek market was put into the international spotlight and attracted significantly more foreign investments.[365] At the same time, the Greek Governments encourage foreign direct investments (FDI's) as a matter of policy and a range of effective measures have been introduced to make the country more attractive to FDI's. Against this objective, a new Investment Incentives Law has been passed, along with the tax reforms.[366] Both these regulatory initiatives aim to cut red tape, which exists both at the opening of an enterprise and during its whole function, and simplifying the tax structure to foster investments.

According to data by the Hellenic Centre for Investment, (ELKE), FDI's in Greece have improved over the last few years as foreign enterprises

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[364] The foreign institutional investors, who as shown by international practices and surveys (*see, e.g.*, Felton, R. F., A. Hudnut, and J. van Heeckeren, 'Putting a Value on Corporate Governance' (1996) 4 The McKinsey Quarterly 170) are willing to pay a premium for a well-governed company, do not form a large part of today's investors in the listed companies in the ASE, *see, e.g.*, Mouzoulas, S., *Law 3016/2002 on Corporate Governance: Article by Article Analysis - Evaluation from Institutional Investors' Perspective* (in Greek) (Sakkoulas Publications, Athens, 2003).

[365] *See, e.g.*, — 'Business and Investment Prospects strong after Olympic Games Triumph', Our World, by USA Today (29 December 2004).

[366] Hellenic Law 3299/2004 on Private Investment Incentives for Economic Development and Regional Convergence, Official Government Gazette A261/ 23.12.2004, as last amended by Law 3468/2006 (Official Government Gazette A129/ 27.6.2006) funds up to 55% of the investments made by older or newly established companies. *See, e.g.*, Ministry of Economy and Finance, 'National Reform Program for Growth and Jobs: 2005-2008' (2005), at 26.

investing in Greece rise in numbers, while foreign enterprises already based in Greece reinvest their profits.[367] In this new era of increased FDI's in Greece, the largest FDI in Greece's history is the sale of Emporiki Bank that was finalised on 14 August 2006.[368] Such developments with increased foreign elements in the Greek securities and financial markets will intensify the debate of corporate governance and is to be advanced to a key priority for all Greek companies, as a means to survive from strong competitive forces.

In strong relation to the above, the membership of Greece in the EU and particularly, recently, in the EMU, makes the Greek corporate landscape a dynamic one. The impact of the EC law has been so pervasive that to discuss Greek capital markets law otherwise than in the light of Greece's compliance with its EC Treaty obligations would be tantamount to disregarding an essential ingredient in its ongoing reform process. For over a period of almost 25 years, a tendency of the Greek legislator to closely follow the developments in the European Union legislation is evident.[369] Remarkably, only occasionally does the Greek regulator take own legislative initiatives to address domestic needs, and rather those initiatives are primarily based on international pressure.

The Greek stock market capitalization is in line with other European countries but has suffered an acute boom-bust cycle and the market is quite illiquid. The Greek capital market has a limited range of products with core

[367] FDI's to Greece recorded a net inflow of € 893 million in the January-May 2006 period, sharply up from a net inflow of € 59 million in the corresponding period last year. (FDI recorded a net inflow of € 519 million in May alone helped by the inflow of € 392 million by Dubai Financial to buy a 31.5% equity state in Greece's Marfin Financial Group), *see, e.g.*, ELKE, 'Greece Reports Steady Inflow of FDI', Investment Tracker, July and August 2006.
[368] The French bank Credit Agricole S.A. on 14 August 2006 increased its shares to Emporiki Bank S.A. from 8.83% to 71.97%. *See, e.g.*, Emporiki Bank, 'Changes in the Shareholding Structure of the Bank' Press Release (14/08/2006).
[369] *See, e.g.*, Athanassiou, P., 'Recent Developments in Greek Capital Markets Law' (2005) 16 (4) EBLR 893, 898.

product the ordinary share. There are few corporate bond issues and very limited secondary market transactions.[370] In view of such structure there is limited scope for the development of instruments and mechanisms necessary for asset management and pension funds.

The mutual fund industry is relatively small but increasing and is dominated by the banks. Derivative markets are also relatively limited. The trading volumes in futures and options that are traded on the ADEX are equally low. A testament to that is the fact that although banks use interest rate swaps and currency futures to hedge exposures, they are not active in credit derivatives markets.[371]

According to the IMF's assessment for Greece, the future role of capital markets is estimated to be constrained by the limited financial disclosure and the uneven introduction of IAS / IFRS, since almost 70% of the Greek corporations are not listed on the ASE therefore their application appears as an obligation only for the 30% of the listed companies. Additionally, such uneven introduction of IAS / IFRS rules creates problems in comparing the performance and the good standing of companies since their balance sheets will certainly make them difficult to compare. In that context, close monitoring by the Greek authorities on those companies that still report under the Greek Generally Accepted Accounting Principles (GGAAP) is important.[372]

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370 *See, e.g.*, International Monetary Fund, 'Greece: Financial System Stability Assessment: Including Reports on the Observance of Standards and Codes on the Following Topics, Banking Supervision, Insurance Supervision, Securities Regulation, and Anti-Money Laundering and Combating the Financing of Terrorism', Country Report 06/06 January (2006) at 12.

371 *Id.* at 10.

372 *See, e.g.*, International Monetary Fund, 'Greece: Financial System Stability Assessment: Including Reports on the Observance of Standards and Codes on the Following Topics, Banking Supervision, Insurance Supervision, Securities Regulation, and Anti-Money

In the specific context of the region of Balkans, the Greek capital market is regarded as the most advanced one. Greece has a leading and important role to play in the Balkans. A testament to that is the recent increased activity of Greek banks that have focused their future strategic planning in the expansion of their operations in the countries of the Balkans and in particular, in Romania, Serbia and Montenegro, Bulgaria and Turkey.[373] Greek banks have increased their claims in the Balkan region, which shows a high growth potential.[374] Such expansion takes place through Mergers and Acquisitions and the formation of foreign branches and subsidiaries.[375]

Against this background, the introduction of good corporate governance for the Greek market is considerably necessitated by the impetus of the unprecedented capital market growth in Greece. In the context of capital markets' integration and the general globalisation process that results in an increased interaction of capital markets, countries are prompted to advance or modernise their practices in order to remain competitive in the global capital market arena. Likewise, Greece has a strong interest in keeping up with the international pace with regard to corporate governance rules.

Laundering and Combating the Financing of Terrorism', Country Report 06/06 January (2006) at 10.

[373] In April 2006, an agreement was reached between the National Bank of Greece (No. 1 Greek bank) and Finansbank (Turkey), where NBG will acquire the 46% of the Turkish bank. For more information, visit http://www.reporter.gr where an overview of the acquisition is provided.

[374] *See, e.g.*, Bank of Greece, 'Annual Report' (2005).

[375] From a legal perspective, whereas these new-established entities in the Balkans are governed by their local rules and regulations, at the same time they have to comply with the general rules and guidelines as set by the Group, in which they belong. This increases the need for the development of good corporate governance rules in order to create a strong, competitive and stable formation. Additionally, the fact that these Balkan countries have been championed for weak legal structures and protections, the Greek groups that seek to expand their operations to these countries must take all appropriate measures (including strong corporate governance rules) to safeguard their ongoing operations and activities.

4. THE GREEK CORPORATE GOVERNANCE UNIVERSE

Introduction

In further sharpening our understanding of the Greek corporate governance universe, the analysis shifts to discuss first, the evolution of the Greek corporate governance rules; second, the main provisions of the Corporate Governance Law of 2002; third, the Greek securities and capital market legislation; fourth, the EC capital market law; and fifth, the OECD principles.

The main proposition argued at the core of this thesis is that the general, overlapping to some certain extent, corporate governance requirements and the inherently rigid civil law system give rise to an overly bureaucratic legal framework. Therefore, the effects of such situation are, *inter alia*, that Greek corporations are facing complexities and difficulties in adapting to regulations, further explaining the moderate levels of compliance, as shown in the next chapter. This affects the level of efficiency of the Greek corporate governance framework.

The Evolution of the Greek Corporate Governance Universe

Before analysing the main corporate governance provisions that govern the operation of Greek corporations it is helpful to briefly sketch the key dates when major corporate governance developments took place. More particularly, the debate on corporate governance in Greece first arose in May 1998. At that time two important facts occurred. First, the ASE was used, mainly for domestic investors, as a good conduit to invest in Greece's growing economy and the potential expansion of the Greek financial and securities market. Second, at that time, the Athens Stock Exchange (ASE), in coordination with ASYK S.A., conducted a survey on corporate governance regarding specifically a review of the mechanisms to control and monitor the management of corporations.[376] This study was the first step for the future development of recommendations and rules for listed companies in the ASE and its timing is strongly associated with ASE's expansion, the increased need for instilling investors' confidence, and the boost of transparent procedures.[377] The effect of this survey was very important, since it led to the consultation of corporations relating to several issues of the public companies' *(sociétés anonymes)* governance. This consultation was primarily employed at a stock exchange level and later at the level of a special Committee, which was to be established to perform this task in the first place.

In April 1999, the Hellenic Capital Market Commission (HCMC), expressing its interest in the establishment of efficient corporate governance practices, set up the Committee on Corporate Governance in Greece. This Committee published in October 1999 a White paper titled *'Principles of Corporate Governance in Greece: Recommendations for its competitive transformation'*, which is known thereafter as the Mertzanis Report.[378] The

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[376] *See, e.g.,* ASE / ASYK SA, 'Systems of Corporate Control' (1998).
[377] *See, e.g.,* Doukas, P. G., *Corporate Governance, Securities, Stock Exchanges and Corporations' Evaluation* (in Greek) (I. Sideris Publications, Athens, 2002), at 71.
[378] *See, e.g.,* Committee on Corporate Governance in Greece (under the coordination of the HCMC) 'Principles on Corporate Governance in Greece: Recommendations for its Competitive Transformation' (The Mertzanis Report) 1999 Athens, Greece. On the provisions of the White paper, *see, e.g.,* Mouzoulas, S., *Law 3016/2002 on Corporate Governance: Article by Article Analysis - Evaluation from Institutional Investors' Perspective* (in Greek) (Sakkoulas Publications, Athens, 2003); Mouzoulas, S., *Corporate Governance: International Experience, Greek Reality* (in Greek) (Sakkoulas Publications, Athens 2003); Spanos, L., 'The Evolution of Corporate Governance in Greece' (paper presented at the First LSE PhD Symposium on Modern Greece: Current Social Science Research on Greece, London School of Economics, Hellenic Observatory, 21 June 2003, London); Mouzoulas S., 'The Governance of Listed Companies' (in Greek) (speech to the 9th Conference on Commercial

Mertzanis Report stresses the necessity of good and efficient corporate governance as a vital prerequisite to competitively transform and modernize the Greek capital market and economy.[379] This voluntary corporate governance code was developed in collaboration with all the relevant agents in the Greek economy and was made on the basis of internationally accepted terms and conditions that reflected the experience of other countries and took into consideration problems that arose during the implementation of other regulations by financial authorities. The principles and best practices contained were closely modelled the OECD Principles on Corporate Governance.[380]

The Mertzanis Report contained 44 recommendations compiled into seven main categories and these recommendations were based on the satisfaction of three basic principles: transparency, consistency and accountability.[381] The Report recognized the key role for efficient governance of the corporation's Board of Directors, which would assume as its main responsibility to ensure the establishment of efficient governance rules. Likewise, the General Shareholders Meeting would have a very important role in the supervision of the management to the extent that it would still be the

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Law, Delfoi 12-14 November 2000, Greece); and Perakis, E., 'The Governance of Listed Companies' (in Greek) (speech delivered to the 9th Conference on Commercial Law, Delfoi 12-14 November 2000, Greece).

[379] *See, e.g.*, Committee on Corporate Governance in Greece (under the coordination of the HCMC) 'Principles on Corporate Governance in Greece: Recommendations for its Competitive Transformation' (The Mertzanis Report) 1999 Athens, Greece.

[380] *See, e.g.*, OECD (2004) 'OECD Principles of Corporate Governance'.

[381] The main categories were the following: the rights and obligations of shareholders; the equitable treatment of shareholders; the role of stakeholders in corporate governance; transparency, disclosure of information and auditing; the board of directors; the non-executive members of the board of directors; and the executive management. *See, e.g.*, Committee on Corporate Governance in Greece (under the coordination of the HCMC) 'Principles on Corporate Governance in Greece: Recommendations for its Competitive Transformation' (The Mertzanis Report) 1999 Athens, Greece.

competent organ for the approval of certain acts, aiming at the transparency of their implementation.

Notwithstanding that the Mertzanis Report was recognized to be the first step towards good corporate governance, criticisms and reservations were expressed on the coherence of the principles recommended, since they were either reiterated in older legal documents, such as the Corporations' Law,[382] or their introduction seemed problematic, giving rise to interpretative ambiguities and enforcement complications.[383] Therefore, the challenge for Greek legislators was to avoid structuring Greece's corporate governance as a wholesale transplantation of the Anglo-Saxon model or any other corporate governance model. Rather, it seemed important that Greece's corporate governance efforts focus on incorporating basic corporate governance elements into the Greek system, while developing national solutions to problems that are unique in the Greek business landscape.[384]

Whereas the initial introduction of corporate governance rules in the Greek capital market followed the method of self-regulation (soft law) with the Mertzanis recommendations and best practice rules, the first regulatory intervention of the Greek regulators took place in 2002. At that time, the Ministries of National Economy and Development, under the coordination of the HCMC, set up, in 2000, a law making Committee on corporate

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[382] *See, e.g.*, Hellenic Law 2190/1920 *on Public Limited Liability Companies* (sociétés anonymes), Official Government Gazette A37, as codified.

[383] For a criticism on the recommendations of the Mertzanis Report, *see, e.g.*, Mouzoulas, S., *Law 3016/2002 on Corporate Governance: Article by Article Analysis - Evaluation from Institutional Investors' Perspective* (in Greek) (Sakkoulas Publications, Athens, 2003); Mouzoulas, S., *Corporate Governance: International Experience, Greek Reality* (in Greek) (Sakkoulas Publications, Athens 2003); and Perakis, E., 'The Governance of Listed Companies' (in Greek) (speech delivered to the 9th Conference on Commercial Law, Delfoi 12-14 November 2000, Greece).

[384] *See, e.g.*, Mertzanis, H. V., 'Principles of Corporate Governance in Greece', (2001) 9 (2) CG 89, 90.

governance (*vis-à-vis* the *'Rokkas Committee'*). The primary aim of the 'Rokkas Committee' was to present a legislative document on corporate governance that could provide the basis for the Greek government's initiative to transform the entire corporate legal framework, conditioning the operation and behaviour of listed and non-listed corporations.

In light of an imminent legislative intervention to regulate corporate governance in the fashion of 'hard law', the Greek corporations and trade unions strongly expressed their dissatisfaction. The main argument that Greek firms stressed was the fact that self-regulation was deemed the optimal means to introduce rules on corporate governance. Self-regulation was viewed by firms as the only way of introducing corporate governance rules ensuring at the same time the flexible and dynamic character of these rules, along with the fact that self-regulation was in line with the market operations.[385]

The strong resistance and dissatisfaction of the Greek firms in the legislative fashion of promoting corporate governance rules opened the way to a new era in corporate governance law making methods in the Greek business sector. A legal manifestation of that is the enactment of the Law 2836/2000,[386] which pursuant to Article 1, paragraph 3, the HCMC assumes legislative power to introduce and enforce a code of conduct for listed companies in the ASE and their competent organs. The HCMC Code of Conduct was issued in November 2000, which decisively contributed to the enhancement of

[385] *See, e.g.*, Mouzoulas, S., *Law 3016/2002 on Corporate Governance: Article by Article Analysis - Evaluation from Institutional Investors' Perspective* (in Greek) (Sakkoulas Publications, Athens, 2003), at 4.

[386] *See, e.g.*, Hellenic Law 2836/2000 *on Completion of Hellenic Capital Market Commission Regulation, Amendments Concerning the Public Real Estate Company, Insurance Compensations, Value Added Tax, Investing Gold and Other Provisions'*, Official Government Gazette A168/ 24.07.2000, as last amended by Law 3371/2005 (Official Government Gazette A178/ 14.07.2005).

transparency and disclosure regarding the behaviour of listed companies in the Greek capital market.[387]

Until that time, the Greek business sector had witnessed the introduction of corporate governance rules both at a voluntary basis (e.g. the Mertzanis Report) and at a more legislative fashion (e.g. HCMC Code of Conduct), but the effects were still limited. The Greek companies did not widely apply the Mertzanis corporate governance recommendations and such reluctance was partly justified on the grounds that these rules were of unsatisfactory low quality, coupled also with the certain degree of unfamiliarity of Greek firms with the corporate governance concerns.[388]

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[387] *See, e.g.*, HCMC Rule 5/204/14.11.2000 *on the Code of Conduct for Companies Listed on the Athens Stock Exchange and Connected Persons'*, Official Government Gazette B1487/ 06.12.2000, as amended by HCMC Decisions 3/348/2005 (Official Government Gazette B1081/ 01.08.2005) and 7/372/15.02.2006 *on Amendment of HCMC Rule 5/204/14.11.2000* (Official Government Gazette B247/ 27.02.2006) (The HCMC Code of Conduct for Listed Companies); and Spanos, L., 'The Evolution of Corporate Governance in Greece' (paper presented at the First LSE PhD Symposium on Modern Greece: Current Social Science Research on Greece, London School of Economics, Hellenic Observatory, 21 June 2003, London) at 13. The HCMC Code of Conduct for Listed Companies along with the Law 1969/1991 (*see, e.g.*, Hellenic Law 1969/1991 *on Portfolio Investment Companies, Mutual Funds and Other Provisions Aiming at the Modernisation and Improvement of the Hellenic Capital Market Commission*, Official Government Gazette A167/ 30.10.1991, as last amended by Law 3371/2005 *on HCMC issues and other provisions*, Official Government Gazette A178/ 14.07.2005), the Law 2836/2000 (Hellenic Law 2836/2000 *on Completion of Hellenic Capital Market Commission Regulation, Amendments Concerning the Public Real Estate Company, Insurance Compensations, Value Added Tax, Investing Gold and Other Provisions*, Official Government Gazette A168/ 24.07.2000, as last amended by Law 3371/2005, Official Government Gazette A178/ 14.07.2005); and Section A of the Presidential Decree 348/1985 (*See, e.g.*, Presidential Decree 348/1985 *on Determination of Conditions for the Edition, Audit and Publication of the Prospectus to be Published for Securities Listing in the ASE*, Official Government Gazette A125/ 04.07.1985, as amended by Law 3401/2005, Official Government Gazette A257/ 17.10.2005) represent a major contribution to the enhancement of transparency and disclosure regarding the behaviour of listed companies in the capital market. The primary aim of the Code is to promote corporate transparency, protect investors, interests against corporate mismanagement and enhance the investors' confidence in the ASE. Most importantly, on disclosure matters, the Code specifies that shareholders already owning more than 10% of the listed company's stock and intend to buy or sell additional shares that correspond to at least 5% of the company's stock are obliged to announce their intention before the transaction. This has to be noted that reflects an important advance over previous regulations, such as the Presidential Decree 51/1992 (Presidential Decree 51/1992 *on Information to be Published on Cross-Shareholdings by ASE Listed Companies in Accordance with Council Directive (EEC) 88/627*, Official Government Gazette A22/ 14.02.1992, as last amended by Law 3340/2005, Official Government Gazette A112/ 10.05.2005).

[388] *See, e.g.*, Mouzoulas, S., *Corporate Governance: International Experience, Greek Reality* (in Greek) (Sakkoulas Publications, Athens 2003), at 36.

Soon, the voluntary codes and best practices on corporate governance were replaced by legislative rules, something that was not welcomed by the Greek firms. Against this controversy, the Federation of Greek Industries (FGI), which is now called the Federation of Business and Industries (FBI)[389] and the Union of listed companies in the ASE issued, in August 2001, the voluntary 'Principles of Corporate Governance', as a means to demonstrate their preference in self-regulation. Although the scope of application of those principles could cover all companies, its special focus was declared to be the ASE listed companies. One of the main recommendations included the establishment of board level committees consisting of a majority of non-executive directors and the implementation of internal control by a specific department or individual.

In March 2002, the Centre of Financial Studies of the University of Athens presented its corporate governance rating methodology, in the ASE. The research team, with a grant by the ASE, set up a Special Advisory Committee on Corporate Governance, consisting of members of all the relevant authorities.[390] The findings of the questionnaire-based work on the evaluation of the level of corporate governance of listed companies on the ASE showed (i) a strong preference of Greek companies to self-regulatory

[389] It is important to note that the Federation of Business and Industries has been re-baptised three times in its history. From the original Federation of Greek Industries and Crafts in 1907, in 1946, it became the Federation of Greek Industrialists, and then in 1979 the Federation of Greek Industries. These name changes mirror strategic developments in the nature of Greek business, the economy and society, and point to the Federation's desire to move along with these developments and play a leading role within them. The new Statute aims to allow more flexibility to the Federation. *See, e.g.*, Daskalopoulos, D., (speech by the President of the Federation of Greek Industries – SEV- at the afternoon session of the Annual General Assembly, Athens, Greece, 24 May 2007) (in Greek).

[390] The Hellenic Capital Market Commission; the Athens Stock Exchange; the Federation of Greek Industries; the Athens Chamber Commerce & Industry; the Union of Institutional Investors; Hellenic Bank Association; and the Union of Brokerage Firms.

corporate governance principles; and (ii) a moderate level of corporate governance compliance that needs to further improved.[391]

The Ministries of National Economy and Development and the HCMC, deviated from the self-regulation and initiated the introduction of corporate governance rules through legislative means. The manifestation of this shift was the enactment of the Corporate Governance Law in May 2002.[392] Besides the fact that the enactment of this Law took place in a climate of objections and opposition, it was viewed as a major development in Greece.[393] New regulations were needed in order to capture modern corporate governance issues that older legal pieces could not address. This is so because prior to the enactment of the Corporate Governance Law of 2002, the efficient operation of public limited companies through its proper management, the protection of its minority shareholders, and the transparency standards were primarily secured by the Corporations' Law dated back in 1920, as amended, along with the Presidential Decree 350/1985.

Not long after the enactment of the Corporate Governance Law of 2002, it was amended by Laws 3091/2002 and 3371/2005. This reflects two issues. One, that good corporate governance has been high up in the agenda of Greek corporations. Two, the first version of the Corporate Governance Law

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[391] *See, e.g.,* Xanthakis M., L. Tsipouri and L. Spanos, *Corporate Governance: the Concept and Evaluation Methods* (in Greek) (Papazisis Publications, Athens, 2003), at 111-132.
[392] *See, e.g.,* Hellenic Law 3016/2002 *on Corporate Governance, Board Remuneration and Other Issues*, Official Government Gazette 110/ 17.05.2002, as amended by Law 3091/2002, (Official Government Gazette A330/ 24.12.2002). [Hereinafter the Corporate Governance Law of 2002]. The Corporate Governance Law of 2002 was based on the initial plan of the 'Rokkas Committee'. *See, e.g.,* Spanos, L., 'The Evolution of Corporate Governance in Greece' (paper presented at the First LSE PhD Symposium on Modern Greece: Current Social Science Research on Greece, London School of Economics, Hellenic Observatory, 21 June 2003, London), at 16.
[393] For a criticism on the Law, *see, e.g.,* Hadjiemmanouil, C., 'Corporate Governance' (in Greek) (speech to the Institute of Democracy Konstantinos Karamanlis, April 2002) Working Paper Series 15.

of 2002 was not well-drafted, therefore, immediate amendment and completion was needed.

The Corporate Governance Law of 2002 lays down fundamental corporate governance obligations, which intend, *inter alia*, to foster transparency, ensure business development and protect investors' and shareholders' rights. The core requirements of the Law centre on the composition of the Board of Directors (Articles 2-4); non executive director's remuneration (Article 5); internal auditing (Articles 6-8); and share capital increases (Article 9). However, the main argument against this Law advanced is that it only reiterates provisions already proclaimed by other legal texts (basically the Corporations' Law[394]). Against the limited effects of the provisions of the Law, its binding character is counter balancing any criticisms on its purpose.

In July 2002, the ASE followed a unique approach in the promotion of corporate governance rules, aiming to create incentives to all listed companies to apply good governance practices that could lead to better performance and increased firm value. Therefore, the ASE encourages listed companies to adopt qualitative criteria with which to assess their organization and operation and thus contribute to their higher visibility in the capital market and to the improved information of investors. Such qualitative criteria have been developed following a study by the Research and Development Department of the ASE and they were finalized in consultation with listed companies and the associations that represent them.

[394] *See, e.g.*, Hellenic Law 2190/1920 *on Public Limited Liability Companies* (sociétés anonymes), Official Government Gazette A37, as codified.

The optional application of these criteria, which are additional to the legal requirements of the Law, is based upon the active behaviour of listed companies.[395] Such method, which can be classified somewhere between the method of self-regulation and legislative intervention was not developed without concerns on its efficiency.[396] Mainly, concerns were advanced on the possibility of false evaluation and classification of a company.

In 2005, and most recently in 2006, the Athens University of Economics and Business in cooperation with Grant Thornton conducted a Corporate Governance survey, assessing the level of corporate governance compliance in the Greek business landscape.[397] The primary objective of the survey was to map the corporate governance practices of the Greek listed companies. According to the main findings of the survey the issue of corporate governance has been advanced to an important one both from a regulatory/supervisory perspective and also listed companies have recognized its value. The survey concluded that 30% of the Greek listed companies apply corporate governance rules, whereas almost 70% explain their reasons for not abiding by such rules. Overall, significant progress took place, yet there is much room for more improvement. The majority of the Greek listed companies, which seem to comply with the nominal legal demands of the legislator, fail fully to capture the rationale of corporate governance principles, such as those of the OECD.

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[395] *See, e.g.,* Athens Stock Exchange, (Press Release) 'Qualitative Criteria covering Corporate Governance, Transparency and Communication with Investors' (in Greek) ATHEX Board of Directors 27 June 2002.

[396] *See, e.g.,* Mouzoulas, S., *Corporate Governance: International Experience, Greek Reality* (in Greek) (Sakkoulas Publications, Athens 2003), at 38.

[397] *See, e.g.,* Grant Thornton and the Athens University of Economics and Business, *'2005 Corporate Governance Survey'* (2005); and Grant Thornton and Athens University of Economics and Business, *'2006 Corporate Governance Survey'* (in Greek) (2006). [Hereinafter, the 2005 Corporate Governance Survey and the 2006 Corporate Governance Survey, respectively].

The Corporate Governance Law of 2002[398]

Notwithstanding the general agreement that Greece's corporate governance environment should not be structured as a wholesale transplantation of the Anglo-Saxon model or any other corporate governance model, the Mertzanis Report and the enactment of the Corporate Governance Law of 2002 give rise to scepticism and dilemmas. Whereas the former represents a mere translation of the OECD Principles of Corporate Governance into Greek without specific reflections of the Greek environment, the latter creates a severe confusion about the real intentions of the legislator.

The contents of the Corporate Governance Law of 2002, which focus to a large extent on the formation and the activities of the Board of Directors (including the responsibilities, the participation of non executive members of the Board, and independent non executive members), and the publication of Internal Mechanism Regulation,[399] reveal that the Greek legislator's initial intentions were to follow the UK practice based on the Cadbury Committee principles.[400] Even if the intention of the legislator was to follow the example of the Cadbury Committee with several years of delay, certain specifications were not taken into account (such as for instance the lack of a definition of independence), which can result in an increased operational cost for small Greek companies.

[398] *See, e.g.,* Hellenic Law 3016/2002 *on Corporate Governance, Board Remuneration and Other Issues,* Official Government Gazette 110/ 17.05.2002 as amended by Law 3091/2002, (Official Government Gazette A330/ 24.12.2002).

[399] The term Internal Mechanism Regulation can be also read as Internal Regulation. These two terms are used interchangeably throughout this thesis.

[400] *See, e.g.,* Committee on the Financial Aspects of Corporate Governance (The Cadbury Committee), '*Financial Aspects of Corporate Governance*' (1992) December (the Cadbury Report).

More particularly, the specific formation of the Board of Directors and the participation of non executive members served particular dynamics of the British ownership and management structures of UK listed companies, which do not necessarily serve relevant dynamics in the Greek capital and stock market. The Greek companies characterised by concentration of ownership (more often than not family firms) should be governed by a corporate governance framework that would not merely underline the participation of non-executive members in the Board of Directors but should pay more attention to the role and duties of the members of the Board.

The focus of the analysis now shifts to discuss the main provisions of the Corporate Governance Law of 2002 aiming to highlight the following issues. First, that the Board of Directors, the Internal Regulation, and the Internal Audit are the cornerstone of the Greek corporate governance system. Second, that the title of the Law is to a certain extent misleading given that the Law at its substance governs matters relating to the Board of Directors, without dealing with other corporate governance issues, such as the relationship between shareholders and the management. It follows that the Corporate Governance Law of 2002 could be well called as the 'Board of Directors' Law. Third, that the rules embodied in the Law are general, inadequate, and not clearly articulated. Fourth, throughout the analysis, the reasons that led the Greek regulator to adopt a 'hard law' approach to corporate governance are not evident. Fifth, alongside the absence of an imminent need for the Law, significant regulatory overlaps are identified, which further point towards this Law being unnecessary. Sixth, any positive effects and the achievement of the objectives of the Law seem to be undermined by its very nature (hard law). Seventh, the Law moves between the boundaries of capital market law and company law, which deprives it of clear legal orientation, creating confusion with respect to supervisory issues.

Therefore, the main proposition at the core of the thesis is supported and it is further evident that the aforementioned facts tend to weaken the efficiency of the Greek corporate governance system. The concerns on the added value of the Corporate Governance Law of 2002, although raised in the controversy developed already from the first draft proposal, were not able to be overcome. However, the amendments that were introduced in a very short period of time after its passing revealed in the most prominent way its problematic fate.

Scope of application (Article 1)

Pursuant to Article 1, *'the provisions of the Corporate Governance Law are applied to* sociétès *anonymes, which are in the course of listing or have their shares or other transferable securities listed in a regulated stock market'*. Here, variable interpretations have been stressed with regard to the scope of application of the Corporate Governance Law of 2002, since the Greek corporate governance principles are both a matter of company and capital markets law. From a company law perspective, the Corporate Governance Law of 2002 seems to be applicable only to the companies established in Greece, whereas according to the capital markets law, the decisive parameter to define the scope of the Law is the listing in a regulated stock market.[401]

[401] The use of the term 'regulated stock market' reflects the intention of the regulator not to restrict the application of the provisions of the Law only on the listed on the ASE but rather to include companies listed on other regulated stock markets that have been developed at the time of the enactment of the Law or will be developed in the future. Strictly speaking the adoption of the term 'regulated stock market' conflicts with the relevant term used in Law 2396/1996 (*see, e.g.,* Hellenic Law 2396/1996 *Investment Services in the Securities Field,*

The Corporate Governance Law of 2002 does not change nor reject the provisions proclaimed by the Hellenic Law 2190/1920, as codified,[402] which governs the main operations of the sociétès anonymes (at the apex of which stands the Board of Directors). On the contrary, it is stated, *'the provisions of the Law 2190/1920, as codified, are in force as long as they do not conflict with the provisions of the present Law'*. Here two important observations can be made.

First, that such an approach substantially differs from the stance adopted in the Mertzanis Report in 1999, according to which *'the Committee of Corporate Governance is of the view that the Law 2190/1920 has constituted an essential contribution to the development of the legal framework for the corporate operation and behaviour the last 80 years. However, the Law including its successive modifications is rather inadequate in providing the basis for the effective settlement of current corporate issues as they arise in the modern corporate world. Indeed, the Law does not include basic concepts, terms and conditions required for the development of a modern and efficient corporate governance framework. The subsequent issuance of Presidential Decrees 350/1985[403] and 51/1992[404] and a series of*

Capital Adequacy of Investment Services Firms and Credit Institutions and Shares' Dematerialisation, Official Government Gazette A73/ 30.04.1996, as last amended by Law 3371/2005, Official Government Gazette A178/ 14.07.2005), which incorporates into the domestic legal order the Investment Services Directive (*See, e.g.,* Council Directive (EEC) 1993/22 of 10 May 1993 on investment services in the securities field [1993] OJ L141/27). In the latter, it is used the term 'regulated market' and these usage differences can give rise to interpretation problems.

[402] *See, e.g.,* Hellenic Law 2190/1920 *on Public Limited Liability Companies* (sociétés anonymes), Official Government Gazette A37, as codified.

[403] *See, e.g.,* Presidential Decree 350/1985 *on Listing Requirements in the Athens Stock Exchange and Issuers' Duties and Obligations,* Official Government Gazette A126/ 04.07.1985, as last amended by Law, as last amended by Law 3401/2005 (Official Government Gazette A257/ 17.10.2005).

[404] *See, e.g.,* Presidential Decree 51/1992 *on Information to be Published on Cross-Shareholdings by ASE Listed Companies in Accordance with Council Directive (EEC) 88/627,* Official Government Gazette A22/ 14.02.1992, as last amended by Law 3340/2005 (Official Government Gazette A112/ 10.05.2005).

Ministerial Decisions have contributed significantly in the meeting of considerable regulation need, without however providing a full solution to the problem'.[405]

It appears that in three years time, the Greek regulator shifted his approach with regard to the role of the Corporations Law, thereby creating confusion to firms.

Second, the reasons that led the Greek regulator to enact one more Law to govern same matters are unclear. This is established given that the main provisions of the Corporate Governance Law of 2002 regulate the specific issues with regard to the board structure (which is also governed by the Corporations' Law) and the operation of listed companies (which is also governed by other capital market law and securities legislation, such as for instance the HCMC Code of Conduct for listed firms[406]). One can argue that the rules in the Corporate Governance Law of 2002 only amend the relevant provisions (e.g. board of directors requirements) of the Corporations Law, without changing the remaining obligations of the Corporations Law. Even in such a case, for the sake of coherence it would be more appropriate for amendments to be incorporated in a later version of the existing Law and not to enact a new one.

Another interesting aspect of the Corporate Governance Law of 2002 is its limited application only to listed firms. Such limited scope gives rise to

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[405] *See, e.g.,* Committee on Corporate Governance in Greece (under the coordination of the HCMC) 'Principles on Corporate Governance in Greece: Recommendations for its Competitive Transformation' (The Mertzanis Report) 1999 Athens, Greece.

[406] *See, e.g.,* HCMC Decision 5/204/14.11.2000 *on the Code of Conduct for Companies Listed on the Athens Stock Exchange and Connected Persons'*, Official Government Gazette B1487/ 06.12.2000, as amended by HCMC Decisions 3/348/2005 (Official Government Gazette B1081/ 01.08.2005) and 7/372/15.02.2006 *on Amendment of HCMC Rule 5/204/14.11.2000* (Official Government Gazette B247/ 27.02.2006).

two contradictory conditions. On the one hand, it is positive that compliance with the provisions of the Corporate Governance Law of 2002 is a prerequisite for firms that wish to list their shares on the stock exchange and an obligation on listed firms, to which failure to comply will bring sanctions and penalties. However, on the other side, the Corporate Governance Law of 2002 leaves unregulated in terms of corporate governance the operation of non listed firms, which particularly in the Greek market are a considerable number, the majority of which are family firms. Therefore, the Greek regulator seems to have implicitly compromised with the initial stance of firms (including family firms) against the imposition of additional obligations. The Greek regulator's intervention rested only at a minimum, without stipulating those obligations to apply to non-listed companies by analogy.

Finally, pursuant to Article 52, paragraph 10, of the recent Law 3371/2005,[407] the Hellenic Capital Market Commission (HCMC) is empowered with the authority to define certain regulated stock markets where the provisions of the Corporate Governance Law of 2002 will not be applied either in part or in full. The latter modification further strengthens the role and responsibilities of the HCMC, as aforementioned. Beyond the enhanced role of the HCMC, this provision reveals the intention of the Greek regulator to classify the Corporate Governance Law of 2002 more as part of the securities legislation and capital market law, rather than a piece of company law. Such intention is also clearly evident from Article 10 of the Corporate Governance Law of 2002, as is analyzed below, pursuant to which the HCMC is empowered with the monitoring and supervisory competencies with respect to

[407] *See, e.g.,* Hellenic Law 3371/2005 *Regarding Issues of the Hellenic Capital Market Commission,* Official Government Gazette A178/ 14.07.2005.

the compliance of firms with the provisions of the Corporate Governance Law of 2002.

Board of Directors (Articles 2-5)

The Board of Directors stands at the apex of the Corporate Governance Law of 2002. Articles 2-5 of the Corporate Governance Law of 2002 specify the duties and the obligations of the Board of Directors of companies listed in regulated stock markets and it also regulates the formation of their Board. This Law, on the premises of Article 2, paragraph 1, that states, *'the principal obligation and duty of the members of the Board of Directors of each company, which is listed in a regulated stock market is the continuous pursuit of the enhancement of the lasting economic value of the company*[408] *and the protection of the general interests of the company* clearly takes a position in favour of the principle of maximisation of shareholder value.[409] Importantly, it is necessary to note that the continuous effort to increase the firm's long-term market value is not the primary obligation of the Board of Directors only of listed firms (or firms in the process of listing their shares on the stock exchange), but likewise for non listed firms. Here the

[408] The Permanent Committee of Economic Affairs within the Greek Ministry of Economy and Finance that was called to evaluate the provisions of the Law prior to its final approval raised its concerns about the usage of the word 'long lasting' versus 'long term', clearly favouring the latter. Depending on which term is adopted, the obligations of the Board of Directors, as envisaged by this provision, can be interpreted in a different way. *See, e.g.*, Permanent Committee of Economic Affairs, 'Preamble on the Draft Law on Corporate Governance' (in Greek) Ministry of Economy and Finance, (April 2002).

[409] This strongly resembles the US and UK corporate governance models, as aforementioned, where it is established that the priority of corporate managers remains shareholder wealth maximisation. Yet, Mouzoulas argues that this provision by stating as a principle obligation of the Board of Directors to *'protect the general interest of the company'* also reflects the stakeholder theory. He further argues that the intentions of the regulator were to attempt a convergence of the shareholder and stakeholder theories. *See, e.g.*, Mouzoulas, S., *Law 3016/2002 on Corporate Governance: Article by Article Analysis - Evaluation from Institutional Investors' Perspective* (in Greek) (Sakkoulas Publications, Athens, 2003), at 39-40.

intention of the Greek legislator is to implicitly apply by way of analogy the objective of the pursuit of firm's long term value for non listed firms.

At paragraphs 2 and 3 of the same article it is provided that *'the members of the Board of Directors and any third party, [...], are prohibited from seeking their own interests, which conflict with the company's interest; and [...] shall disclose in due course any own interests, which shall arise during the exercise of their duties'*. The need for such provision is underlined by the fact the relatively widespread shareholding structure of modern listed companies, as a result of which the activities of the Board of Directors can deviate from the general corporate interest and the protection of the interests of shareholders. The complex structure of modern companies and the financial sophistication in their operation has significantly endangered the interests of shareholders. This risk is intensified by the absence of legal measures to punish corporate wrongdoings and raise claims.

Against this problem, the Corporate Governance Law of 2002 explicitly provides that the Board of Directors and other third parties are prohibited from soliciting their own interests conflicting with the interests of the company. In case of conflicts of interest, a disclosure obligation exists so as to ensure that greater transparency in the relations is achieved between the company and its Board.

Interestingly, Article 23 of the Corporations Law provides the possibility to the members of the Board of Directors to pursue other interests that fall in the sphere of the corporate objectives and purposes *'upon the prior approval by the General Shareholding Meeting'*. It follows that such milder approach to the issue of conflicts of interest creates a regulatory confusion.

Although on the one side, the Corporate Governance Law of 2002 requires disclosure of such conflict of interest, the Corporations Law stipulates prior approval. However, neither the Greek courts nor the regulator have decided whether the different approach by the Corporate Governance Law of 2002 constitutes a conflict with the provisions of the Corporations Law, therefore creating interpretational and implementation concerns.

Furthermore, a brief examination of the effects of the Article 2, paragraph 3, in the context of take over bids, proves their limited practical significance. More particularly, by definition, a take over bid entails a personal interest of the members of the Board to the extent that their position in the new legal entity that will be created after the successful bid, is not secured. Pursuant to Article 2, paragraph 3, the members of the Board are prohibited from determining or influencing the final outcome of a take over bid, so as to serve their own interests. Such action would constitute a severe breach of the said provision, let alone a violation of the business judgment rule. Therefore, in the context of take over bids, the members of the Board are obliged to disclose the existence of a personal interest; an interest that goes beyond the obvious concern on maintaining their position in the Board and rather includes an interest reflecting the existence of personal ties with people from the target company. However, in the Greek practice of take over bids, there has never been recorded a disclosure of such personal interests.[410] Apparently, shareholders almost never possess such facts in order to enable them to take informed and rational decisions.

[410] *See, e.g.*, Mouzoulas, S., *Corporate Governance: International Experience, Greek Reality* (in Greek) (Sakkoulas Publications, Athens 2003), at 255-257.

Paragraph 4 of Article 2 of the Corporate Governance Law of 2002 establishes the obligation of the *'Board of Directors to draft a report, annually, which shall include, in detail, all transactions that the company has entered into with its associated firms [...]. Such report shall be notified also to the supervisory authorities.'* The purpose of this provision is not to block those transactions from being conducted, but rather to make them public, therefore increasing the level of transparency. In turn such disclosure enhances the overall credibility of the company against its shareholders and as such is of utmost importance for the Greek legislator.

Unfortunately, this provision has not come without a drafting weakness. The main problem stems from the general and broad character of this provision that demands to be read in conjunction with another specific rule. This provision avoids referring to the publication frequency and it is only after the implementation of International Accounting Standard (IAS) 24 on related party transactions that this gap is filled.[411]

To continue with Article 3, its essence is based on the separation of executive and non executive Board members,[412] along with the introduction of the independent non executive members of the Board, which is a prevailing corporate governance principle.[413] According to Article 3, paragraph 1, *'the*

[411] IAS 24 'Related-Party Disclosures' introduces to companies the obligation to disclose of information with regard to the existence of related parties and details of their transactions. The objective of the IAS 24 is to ensure that an entity's financial statements contain the disclosures necessary to draw attention to the possibility that its financial position and profit or loss may have been affected by the existence of related parties and by transactions and outstanding balances with such parties.

[412] In practice, this separation of responsibilities and roles between executive and non-executive Board members is already evident in the Greek listed companies.

[413] This is also reflected in Principle 5.6 of the Mertzanis Report. *See, e.g.*, Committee on Corporate Governance in Greece (under the coordination of the HCMC) 'Principles on Corporate Governance in Greece: Recommendations for its Competitive Transformation' (The Mertzanis Report) 1999 Athens, Greece.

Board of Directors consists of executive[414] *and non-executive*[415] *members [...], the number of non-executive Board members should not be lower than one third (1/3) of the total number of Board members [...], at least two of the non-executive members must be independent'.*[416] Notwithstanding that it is mandated by the Corporate Governance Law of 2002 that the Board of Directors shall consist of executive and independent non executive members, this institutional distinction does not abolish the principal nature of the Board of Directors as a joint and solid decision-making entity.[417] Such general provision is to be specified by Article 6, paragraph 2 (b) of the Corporate Governance Law of 2002, which introduces the Internal Mechanism Regulation, where companies need to define the powers of the executive and non executive members of the Board. Here, it is important to note that such distinction between executive and non executive members has been adopted by the majority of the Greek corporations, yet the fact that, as analysed below, there is no definition on independence limits the potential of this provision.

Furthermore, Article 3, paragraph 1 introduces an exemption with regard to the appointment of independent non executive Board members that is worth discussing. It states that *'at least two independent non executive Board members should exist in the Board [...]'* except *'if representatives of*

[414] The Board members dealing with daily administrative issues of the corporation are considered to be the executive members, (Article 3, paragraph 1).

[415] Non-executive are the Board members mandated with the promotion of all corporate issues, (Article 3, paragraph 1).

[416] By way of exception, *'in case where representatives of the minor shareholders are explicitly appointed in the Board and participate therein as members, the participation of independent members is not obligatory'* (Article 3, paragraph 1). Yet, interpretation problems may arise with regard to 'who is regarded as representative of the minority shareholders'. This ambiguity will be solved in due course by court decisions that might be dealt with in front of the Greek courts.

[417] Pursuant to Article 3, paragraph 1, as amended by Article 26, paragraph 1 of the Law 3091/2002, the Board of Directors elects the executive and non-executive board members, whereas the General Assembly of Shareholders is competent to appoint the independent, non-executive Board members.

the minority shareholders are appointed and participate as members in the Board'. In principle, such exception considers that independent non executive members and the representatives of the minority shareholders are equal. However, by definition, the roles of these two classes of directors are different, to the extent that the representatives of the minority shareholders are not independent from the company, since they have certain interests.[418] This is further supported by Article 4, paragraph 1, item (d) that defines *'as a relation of dependence, if a board member [...] (d) has been appointed according to Article 18, paragraph 3 of the Corporations Law'*, which includes, *inter alia*, the representatives of the minority shareholders. Therefore, the application of this exception creates concerns on its correctness and undermines the significance of the appointment of independent non executive Board members.

Article 3 (paragraphs 1 and 2) of the Corporate Governance Law of 2002 shall be read in conjunction with Article 5. In both provisions, the Board of Directors assumes full responsibility to appoint the non executive members of the Board (article 3, paragraph 1), to determine the general remuneration policy[419], and to set the remuneration of non executive board members (article 5). Such responsibility is an absolute one, in the sense that the Board is prohibited from transferring this right to third parties (Article 3, paragraph 2). Notably, such obligation is in contrast with Articles 18, paragraph 2 and 22, paragraph 3, of the Corporations Law, which allows the transfer of the said task to third parties. This conflict between the two Laws is solved by virtue of

[418] *See, e.g.*, Mouzoulas, S., *Corporate Governance: International Experience, Greek Reality* (in Greek) (Sakkoulas Publications, Athens 2003), at 330-331.
[419] It is important to note that the intention of the Greek regulator is not only to stipulate by virtue of Article 3, paragraph 2 that the Board of Directors is responsible to decide upon the general remuneration policy. Most importantly, the Greek regulator implicitly prescribes that the Board of Directors is responsible for implementing such policy. *Id.* at 390.

Article 1 of the Corporate Governance Law of 2002, as analysed above, which states that *'the provisions of the Law 2190/1920, as codified, are in force as long as they do not conflict with the provisions of the present Law'*.

Alongside this conflict, Article 5 that regulates the remuneration of non executive Board members reveals two problems. First, that the introduction of the Corporate Governance Law of 2002 is not deemed necessary to the extent that this provision only makes reference to the relevant provisions of the Corporations Law, without any substantial additions or modifications to it. It is implicitly admitted by the Greek regulator that the Corporations Law is still appropriate and adequate to regulate corporate governance matters. Second, a cross examination of Article 5 of the Corporate Governance Law of 2002 with Article 10, paragraph 4, of the Law 1969/1991[420] that governs the operation of portfolio investment companies and mutual funds brings to the surface significant interpretational problems and confusion. For both reasons, *inter alia*, the extent to which listed companies have properly complied or not with the requirements of Article 5 of the Corporate Governance Law of 2002 is to be decided *ex post* by the competent supervisory authority (the HCMC).[421]

The legal manifestation of the *'protection of the general interest of the company'*, as the primary responsibility of the Board of Directors, is reiterated in Article 4 of the Corporate Governance Law of 2002, which introduces the

[420] *See, e.g.*, Hellenic Law 1969/1991 *on Portfolio Investment Companies, Mutual Funds and Other Provisions Aiming at the Modernisation and Improvement of the Hellenic Capital Market Commission*, Official Government Gazette A167/ 30.10.1991, as last amended by Law 3371/2005 *on HCMC issues and other provisions*, Official Government Gazette A178/ 14.07.2005.

[421] For a more comprehensive discussion of the problematic interaction between Article 5 of the Corporate Governance Law and Article 10, paragraph 4 of the Law 1969/1991, *see, e.g.*, Mouzoulas, S., *Corporate Governance: International Experience, Greek Reality* (in Greek) (Sakkoulas Publications, Athens 2003), at 393-394.

concept of independent non executive Board members. The importance of these members is particularly reflected in the widely-held listed companies, where deviations from the corporate interests are more common and difficult to monitor amid the absence of independent Board members. However, two main criticisms have been raised against the inception of this provision.

First, the concept of independent non executive directors is determined by the use of qualitative criteria. Such criteria are based on the lack of directors' dependence with the company, namely the absence of conflict of interest.[422] Second, the Law does not provide a definition of who is regarded as being independent or what constitutes independence. Rather, the Law defines what constitutes a relation of dependence. It follows that although the intention of the legislator was to determine independent members this has not been achieved. A definitional gap exists, which if not filled, may lead to interpretational problems. Some criticisms also focused on the fact that for the sake of legislative cohesion, the Greek legislator should avoid legislating issues without defining them first.[423]

Building on the above discussion, although not prescribed by the Corporate Governance Law of 2002, it is important that the Board of Directors, on an ongoing basis, verifies the independence of the members of the Board. Namely the Board assumes the responsibility of ensuring the

[422] *See, e.g.*, Mouzoulas, S., *Corporate Governance: International Experience, Greek Reality* (in Greek) (Sakkoulas Publications, Athens 2003), at 327-328.
[423] A similar comment was raised by O. Kyriakopoulos. *See, e.g.*, Kyriakopoulos, O., 'Corporate Governance' (in Greek) (speech to the Institute of Democracy Konstantinos Karamanlis, April 2002) Working Paper Series 15, at 13.

proper implementation of Article 4, paragraph 1, more often than not through adequate mechanisms of internal controls.[424]

Moreover, in order to better safeguard the independence of independent non executive Board members, the Corporate Governance Law of 2002 provides two directions. First, that independent Board members *'may submit, separately or jointly, reports and separate expositions from those of the Board of Directors at the [...] General Assembly of the company, where it is considered necessary'* (Article 4, paragraph 2). Such optional submission, though aims at instilling shareholders' confidence towards the Board of Directors, it has limited effect to the extent that it only presents independent board members with a choice and not a strict obligation.[425] The significance of such choice is at odds, given that it is not coupled with specific guidance on the way by which independent directors can make those submissions. This gap is not filled by other regulatory bodies' rules or acts. Therefore, if this provision provides only a choice without clear guidance, then it is more likely that Greek corporations will not make use of such option.

Second, the independent board members will be appointed by the General Shareholder Meeting (Article 3, paragraph 1). Here the Greek regulator follows the right approach for two reasons. First, because the General Shareholder Meeting is not an executive organ and at the same time, it ensures that decisions are taken upon the principle of majority rule.[426] Second, it safeguards coherence due to the fact that the members of the Board

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[424] *See, e.g.,* Mouzoulas, S., *Corporate Governance: International Experience, Greek Reality* (in Greek) (Sakkoulas Publications, Athens 2003), at 334.
[425] *See, e.g.,* Permanent Committee of Economic Affairs, 'Preamble on the Draft Law on Corporate Governance' (in Greek) Ministry of Economy and Finance, (April 2002).
[426] *See, e.g.,* Mouzoulas, S., *Corporate Governance: International Experience, Greek Reality* (in Greek) (Sakkoulas Publications, Athens 2003), at 328.

of Directors are appointed upon prior decision reached by the General Shareholder Meeting.[427]

Internal Regulation and Internal Audit (Articles 6-8)

In view of the recent capital market developments and the increased sophistication of the global financial markets, the need to introduce the practice of Internal Regulations emerged. In modern publicly held corporations given their widespread shareholding and the lack of adequate monitoring from the principal of the corporation, the management of the company is more often than not prone to serving their own interests.

Against this reality, the Greek legislator imposed on all listed companies the obligation, as envisaged by Article 6 of the Corporate Governance Law of 2002, to issue an Internal Mechanism Regulation.[428] This obligation aims at protecting not only shareholders' interests but also safeguarding -and even boosting- the credibility of the Board. On that basis, the drafting of the Internal Mechanism Regulation by the Board of Directors applies as a requirement for both non listed and listed firms. Whereas for the former, such obligation reflects a necessary prerequisite for them in case that they wish to apply for entry into the ASE (as derives from the obligation that was first introduced by the HCMC Code of Conduct for listed companies[429]),

[427] *See, e.g.*, Mouzoulas, S., *Corporate Governance: International Experience, Greek Reality* (in Greek) (Sakkoulas Publications, Athens 2003), at 329.

[428] Prior to the enactment of the Corporate Governance Law, the Internal Mechanism Regulation was an internal, non public document that was not stipulated as a company law obligation for corporations to publish. The Internal Mechanism Regulation is different from the Articles of Incorporation, with the latter to be superior in case of conflict. In practice, the Internal Mechanism Regulation specifies the provisions of the Articles of Incorporation.

[429] It considerably strengthens the obligation of companies to publish their Annual Report stipulating that the Annual Report shall be available to investors and shareholders 10 working days prior to the General Shareholders Meeting taking place and at the latest 20 working days after the publication of the annual financial statements (Art. 16). *See, e.g.*, HCMC Rule 5/204/14.11.2000 *on the Code of Conduct for Companies Listed on the Athens Stock Exchange and Connected Persons'*, Official Government Gazette B1487/ 06.12.2000, as

for the latter is a binding obligation, failure to comply with brings fines and other sanctions.

Article 6, paragraph 2 of the Corporate Governance Law of 2002, as recently amended by article 32, paragraph 3 of the Law 3340/2005,[430] provides the minimum contents of this Internal Regulation (e.g. the administrative structure of the company;[431] the responsibilities of executive and non-executive Board members; recruitment and selection procedures of executive members;[432] monitoring procedures of transactions, etc.). Its purpose is to promote corporate transparency and better information to investors, which is underlined by paragraph 2.[433]

A careful examination of Article 6, gives rises to two main issues. First, its current wording does not give a clear insight on whether the obligation of the Board of Directors for drafting the Internal Regulation is an exclusive one. Although the provision lacks clarity in that regard, it is presumed that such obligation is exclusive to the Board of Directors. This is supported by virtue of Article 2, paragraph 4 that outlines the main responsibilities of the Board, including that '*the Board of Directors draws an annual report referring in detail to the transactions between the corporation and its subsidiaries*'.

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amended by HCMC Decisions 3/348/2005 (Official Government Gazette B1081/ 01.08.2005) and 7/372/15.02.2006 *on Amendment of HCMC Rule 5/204/14.11.2000* (Official Government Gazette B247/ 27.02.2006).

[430] *See, e.g.,* Hellenic Law 3340/2005 *on the Protection of the Hellenic Capital Market Commission from Insider Dealing and Market Manipulation (Market Abuse),* Official Government Gazette A112/ 10.05.2005.

[431] The structure of the company should include an audit department, investor relations department, and a department for company announcements. (Article 6, paragraph 2, a).

[432] In this sense, the Corporate Governance Law of 2002 imposes the obligation to listed companies to establish such procedures. *See, e.g.,* Mouzoulas, S., *Law 3016/2002 on Corporate Governance: Article by Article Analysis - Evaluation from Institutional Investors' Perspective* (in Greek) (Sakkoulas Publications, Athens, 2003), at 143.

[433] *'[...] the company's Internal Mechanism Regulation must at least provide for departments of Internal Audit, Shareholders' Service and Corporate Announcements.'*

Second, the subject matter of Article 6, paragraph 2, of the Corporate Governance Law of 2002, namely determining the contents of the Internal Regulations, is also covered by Article 11 of the HCMC Code of Conduct for listed companies.[434] This reveals a regulatory duplication with an additional paradox. Article 6, paragraph 2, of the Corporate Governance Law of 2002 is more detailed and specific referring to the minimum contents of the Internal Regulation. On the contrary, Article 11 of the HCMC Code of Conduct for listed companies is much more general mentioning a number of criteria that the Internal Regulation shall meet, without touching upon the issue of its contents. Based on the usual law-making technique applied by the Greek regulator this is paradoxical to the extent that the introduction of rules based on a law (e.g. HCMC rules) are typically more specific and not *vice versa.* Beyond the intentions of the Greek regulator for the detailed nature of this provision, for the sake of regulatory coherence a single legal document should prescribe the contents of the Internal Regulation.

Whereas Article 6 refers to the contents of the Internal Regulation, Articles 7 and 8 focus on the set up, the operation, the powers, and the duties of the Internal Audit, which is first introduced in Article 6, paragraph 2 (a). The internal audit is to be effectuated by a special[435] department of the company, consisting of independent internal auditors,[436] the main duties of which are described in Article 8.

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[434] *See, e.g.,* HCMC Rule 5/204/14.11.2000 *on the Code of Conduct for Companies Listed on the Athens Stock Exchange and Connected Persons'*, Official Government Gazette B1487/ 06.12.2000, as amended by HCMC Decisions 3/348/2005 (Official Government Gazette B1081/ 01.08.2005) and 7/372/15.02.2006 *on Amendment of HCMC Rule 5/204/14.11.2000* (Official Government Gazette B247/ 27.02.2006).

[435] 'Special' in the sense that is the only and exclusive department, integrated in the structure of the company, which is responsible for conducting internal audit.

[436] Pursuant to Article 7, paragraph 3, as amended by Article 26, paragraph 1 (e) of the Hellenic Law 3091/2002 (*on Simplifications and Improvements in the Taxation of Income and*

Notably, the study of Article 7 of the Corporate Governance Law of 2002 supports the proposition at the core of the thesis on the existence of regulatory repetitions. This is confirmed to the extent that the obligation to set up an Internal Audit Department is also covered, though with a range of legal variations, in other legal documents, such as for instance (a) Article 12 of the HCMC Code of Conduct for listed companies;[437] (b) Article 8 of the Code of Conduct of Mutual Fund Management Firms and Investment Services Firms; [438] (c) Section V (a) of the Bank of Greece Governor's Act 2577/2006.[439]

Furthermore, the scope of internal audit is quite broad so as to include the verification not only of the financial statements of the company but also of the internal structure and management of the corporation.[440] Additionally, the

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Capital and Other Provisions, Official Government Gazette A330/ 24.12.2002), *'Internal auditors are appointed by the Board of Directors of the company and are employed full time and exclusively'.* Internal auditors although non executive members of the company, they certainly are members of the company, i.e. not third parties. It follows that the principal intention of the legislator is precisely to block the simultaneous exercise of management and control duties rather than to create an obligation to companies to hire third parties. The issue raised is the extent to which internal auditors are or can be monitored. The answer to this issue is a conflicting one, since literature suggests that internal auditors are monitored by external auditors and vice versa. Yet, the Greek state of auditing affairs underlines, and pursuant to relative legislation, that the set up and composition of internal audit is only monitored by the Board of Directors and not external auditors, whereas their audit mission is supervised by the Internal Audit Department, as envisaged by Article 7, paragraph 2 of the Corporate Governance Law of 2002. Besides, external auditors are commissioned to evaluate the overall effectiveness of internal control systems of a corporation. Internal and external audit are complementary functions, which although share different objectives and aims they co-exist in the context of a corporation without an absolute hierarchical order and superiority.

[437] *See, e.g.*, HCMC Rule 5/204/14.11.2000 *on the Code of Conduct for Companies Listed on the Athens Stock Exchange and Connected Persons'*, Official Government Gazette B1487/ 06.12.2000, as amended by HCMC Decisions 3/348/2005 (Official Government Gazette B1081/ 01.08.2005) and 7/372/15.02.2006 *on Amendment of HCMC Rule 5/204/14.11.2000* (Official Government Gazette B247/ 27.02.2006).

[438] *See, e.g.*, HCMC Decision 8422/132/19.05.1998 *on the Code of Conduct of Mutual Fund Management Firms and Investment Services Firms*, Official Government Gazette B615/ 18.06.1998.

[439] *See, e.g.*, Bank of Greece Governor's Act 2577/2006 *on the Framework Principles for the Operation and Evaluation Criteria of Systems of Internal Controls of Credit Institutions and Financial Institutions and relevant responsibilities of their administrative bodies* (in Greek) Official Government Gazette A59/ 09.03.2006.

[440] The mission of external audit primarily focuses on the verification of the correctness and accuracy of the financial statements and conditions of a corporation. External audit, which is conducted solely by external auditors that do not belong into the company, is supplementary to the internal audit and their objectives although different they seem to converge at some points. On the differences between internal and external audit, *see, e.g.*, Mouzoulas, S., *Law 3016/2002 on Corporate Governance: Article by Article Analysis - Evaluation from*

internal audit is conducted in order to identify dysfunctional management practices and to ensure the sound and proper operation of a corporation through which it indirectly safeguards the interests of shareholders.[441] The internal audit checks the extent to which the investment decisions of the Board of Directors are in conformity with their principle obligation and duty, namely *'the continuous pursuit of the enhancement of the lasting economic value of the company and the protection of the general interest of the company'* (Article 2, paragraph 1).

In the same line of thinking, pursuant to Article 8 (b) of the Corporate Governance Law of 2002, a primary duty of internal auditors is to report to the Board of Directors with regard to conflicts of interest, which is reiterated in Article 2 paragraph 2. In essence, the main focus of the internal audit is the Board of Directors and a testament to that is Article 8(c), which stipulates that the results of the internal audit check are only available to the Board of Directors and are not publicly available information. Internal auditors can disclose information with regard to their check to the supervising authorities (e.g. the HCMC and the ASE), provided that they have received approval by the Board to do so (Article 8, d).

Other Provisions (Articles 9 and 10)

Article 9 introduces specific requirements with regard to share capital increase in cash, aiming at protecting shareholders (minority) and investors as

Institutional Investors' Perspective (in Greek) (Sakkoulas Publications, Athens, 2003), at 163-168.

[441] *See, e.g.*, Mouzoulas, S., *Law 3016/2002 on Corporate Governance: Article by Article Analysis - Evaluation from Institutional Investors' Perspective* (in Greek) (Sakkoulas Publications, Athens, 2003), at 163-168.

the participating parties in the share capital increase.[442] The introduction of this provision is important as a means to enhance greater transparency through timely and accurate information to shareholders and stakeholders.

In practical terms, this provision directly links corporate governance matters with the requirements on the prospectus, as set forth by the Decisions of the ASE Board of Directors Nos. 47 and 48.[443] Such approach is innovative to the extent that international practice has not confirmed it. However some scepticism is raised relating to regulatory overlapping, given that Article 39 paragraph 4 (b) of the Corporations Law, and the Decisions of the ASE Board of Directors Nos. 47 and 48, as aforementioned, adequately govern this issue.

A careful consideration of the interaction of those provisions highlights the following observations. First, the scope of Article 9 of the Corporate Governance Law of 2002 is centred on the obligations of the Board and not the contents of the prospectus, in case of share capital increase, as is in the ASE decisions. Second, paragraph 3 of Article 9 of the Corporate Governance Law of 2002 is innovative to the extent that the ASE decisions do not make reference on the issue of deviations from the use of the drawn capital. Third, the ASE decisions cover also the share capital increase for the purposes of a merger with another company, a provision that is absent from Article 9 of the Corporate Governance Law of 2002. Fourth, there are

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[442] The timing of the introduction of this provision is placed at the period where at the ASE a large number of corporations have submitted their share capital increase reports and at the end it was found that there were dramatic deviations from the use of the drawn capital. *See, e.g.*, Mouzoulas, S., *Law 3016/2002 on Corporate Governance: Article by Article Analysis - Evaluation from Institutional Investors' Perspective* (in Greek) (Sakkoulas Publications, Athens, 2003), at 260.

[443] *See, e.g.*, ASE Board of Directors Decision 47/2000 *on the Prospectus on Share Capital Increase by Cash* (in Greek) Official Government Gazette B1194/ 28.09.2000; and ASE Board of Directors Decision 48/2000 *on the Terms and Conditions for the Approval of the Prospectus in Special Occasions of Share Capital Increase by Cash* (in Greek) Official Government Gazette B1194/ 28.09.2000.

different sanctions for breaches of the provisions, with only administrative ones for breaches of Article 9 of the Corporate Governance Law of 2002 and non approval of the prospectus for the ASE decisions.

Notwithstanding that the general subject matter of those legal documents is the same, there are variations relating to specific requirements.[444] Against this backdrop, the incorporation of this provision in the Corporate Governance Law of 2002 is questionable. Such requirements might be more appropriate to be introduced and defined by the ASE, on the basis of Article 2, paragraph 3, of the Law 2836/2000,[445] as has already been the practice.

Finally, Article 10 refers to the imposition of sanctions to *'any person exercising Board of Directors' powers'*, which is strongly associated with Article 1, paragraph 4 (b) of the Law 2836/2000, on the grounds of which the HCMC is endowed with the authority to impose administrative sanctions and monitor the compliance of the parties subjected to the Law.[446] In practice, the sanctions imposed for breaches of the provisions of the Corporate Governance Law of 2002 amount to the ones envisaged in Law 2836/2000 for breaches of the provisions of the HCMC Code of Conduct.[447] However, as will be shown

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[444] *See, e.g.*, Mouzoulas, S., *Law 3016/2002 on Corporate Governance: Article by Article Analysis - Evaluation from Institutional Investors' Perspective* (in Greek) (Sakkoulas Publications, Athens, 2003), at 267-268.

[445] *See, e.g.*, Hellenic Law 2836/2000 *on Completion of Hellenic Capital Market Commission Regulation, Amendments Concerning the Public Real Estate Company, Insurance Compensations, Value Added Tax, Investing Gold and Other Provisions'*, Official Government Gazette A168/ 24.07.2000, as last amended by Law 3371/2005 (Official Government Gazette A178/ 14.07.2005).

[446] *Id.*

[447] *See, e.g.*, HCMC Rule 5/204/14.11.2000 *on the Code of Conduct for Companies Listed on the Athens Stock Exchange and Connected Persons'*, Official Government Gazette B1487/ 06.12.2000, as amended by HCMC Decisions 3/348/2005 (Official Government Gazette B1081/ 01.08.2005) and 7/372/15.02.2006 *on Amendment of HCMC Rule 5/204/14.11.2000* (Official Government Gazette B247/ 27.02.2006).

in the analysis that follows for a number of reasons there are only few instances where sanctions have been imposed.

The Impact of Different Sources of Law in Determining the Greek Corporate Governance Universe

The Greek Securities and Capital Markets Legislation

As revealed from the detailed analysis of the main provisions of the Corporate Governance Law of 2002, the securities and capital market legislation defines the majority of the Greek corporate governance standards. The main corporate governance requirements are included in the Greek securities and capital markets legislation. For the purposes of improving market efficiency, enhancing transparency, ensuring business development, preventing unfair trade practices, protecting shareholders' rights, and bringing the Greek market up to international and European standards, a package of reforms consisting of measures to liberalize, regulate, and develop the securities market was introduced since the 1990s.

More particularly, the Hellenic Capital Market Commission (HCMC), pursuing its mandate, has enacted five fundamental codes of conduct of business, whose provisions are compulsory for relevant regulated entities. These Codes are the following: (a) the Code of Conduct of brokerage firms and investment services;[448] (b) the Code of Conduct of mutual fund

[448] *See, e.g.*, HCMC Ministerial Rule 12263/B500/11.04.1997 *on the Code of Conduct of Investment Companies Licensed under the Provisions of the Law 2396/1996*, Official Government Gazette B340/ 24.04.1997; and Hellenic Law 2396/1996 *Investment Services in the Securities Field, Capital Adequacy of Investment Services Firms and Credit Institutions and Shares' Dematerialisation*, Official Government Gazette A73/ 30.04.1996, as last amended by Law 3371/2005 (Official Government Gazette A178/ 14.07.2005)), which set up the investment services firms transposing the Investment Services Directive, now MiFID (*see, e.g.*, Council Directive (EC) 2004/39 of 21 April 2004 on markets in financial instruments

management companies and portfolio investment services firms;[449] (c) the Code of Conduct for underwriters and underwriting services;[450] (d) the Code of Conduct of companies listed in the ASE;[451] and (e) the Take-Over Bid Code.[452]

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amending Council Directives (EEC) 85/611 and 93/6 and Directive (EC) 2000/12 and repealing Council (EEC) 93/22 [2004] OJ L145/1; and Council Directive (EEC) 1993/22 of 10 May 1993 on investment services in the securities field [1993] OJ L141/27) and the Capital Adequacy Directive (*see, e.g.*, Council Directive (EEC) 1993/6 of 15 March 1993 on the capital adequacy of investments firms and credit institutions [1993] OJ L141/1). For a comprehensive discussion of the fundamental changes that the Investment Services Directive brought about, *see, e.g.*, Athanassiou, P., 'Recent Developments in Greek Capital Markets Law' (2005) 16 (4) EBLR 893, 897.

[449] *See, e.g.*, HCMC Decision 2/132/19.05.1998 *on the Code of Conduct of Mutual Fund Management Firms and Investment Services Firms*, Official Government Gazette B615/ 18.06.1998, as amended by HCMC Decision 24/318, Official Government Gazette B1843/13.12.2004, and HCMC Decision 8/330, Official Government Gazette B361/ 21.03.2005), which is based on the Hellenic Law 1969/1991, as amended, (*see, e.g.*, Hellenic Law 1969/1991 *on Portfolio Investment Companies, Mutual Funds and Other Provisions Aiming at the Modernisation and Improvement of the Hellenic Capital Market Commission*, Official Government Gazette A167/ 30.10.1991, as last amended by Law 3371/2005 *on HCMC issues and other provisions*, Official Government Gazette A178/ 14.07.2005) and the Hellenic Law 2533/1997 (*see, e.g.*, Hellenic Law 2533/1997 *on Derivatives Exchange and Other Provisions*, Official Government Gazette A228/ 11.11.1997, as last amended by Law 3371/2005, Official Government Gazette A178/ 14.07.2005).

[450] *See, e.g.*, Ministry of Economy and Finance, 'Code of Conduct for Underwriters and Underwriting Services' (in Greek) Ministerial Decision 41517/B1972/04.12.1998, Official Government Gazette B1257/ 15.12.1998, as last amended by decision 6400/B888, Official Government Gazette B625/ 11.05.2005) that was linked with the Law 2651/1998 (*see, e.g.*, Hellenic Law 2651/1998 *on Stock Exchange Market Issues and Other Provisions*, Official Government Gazette A248/ 03.11.1998) including the key requirements for the drawing up, scrutiny, and distribution of the disclosure document to be drawn up and published prior to the admission to listing of securities.

[451] *See, e.g.*, HCMC Rule 5/204/14.11.2000 *on the Code of Conduct for Companies Listed on the Athens Stock Exchange and Connected Persons'*, Official Government Gazette B1487/ 06.12.2000, as amended by HCMC Decisions 3/348/2005, Official Government Gazette B1081/ 01.08.2005, and 7/372/15.02.2006 *on Amendment of HCMC Rule 5/204/14.11.2000*, Official Government Gazette B247/ 27.02.2006, is associated with the Law 1969/1991 (*see, e.g.*, Hellenic Law 1969/1991 *on Portfolio Investment Companies, Mutual Funds and Other Provisions Aiming at the Modernisation and Improvement of the Hellenic Capital Market Commission*, Official Government Gazette A167/ 30.10.1991, as last amended by Law 3371/2005 *on HCMC issues and other provisions*, Official Government Gazette A178/ 14.07.2005), Law 2836/2000 (Hellenic Law 2836/2000 *on Completion of Hellenic Capital Market Commission Regulation, Amendments Concerning the Public Real Estate Company, Insurance Compensations, Value Added Tax, Investing Gold and Other Provisions'*, Official Government Gazette A168/ 24.07.2000, as last amended by Law 3371/2005, Official Government Gazette A178/ 14.07.2005), and Section A of the Presidential Decree 348/1985 (*see, e.g.*, Presidential Decree 348/1985 *on Determination of Conditions for the Edition, Audit and Publication of the Prospectus to be Published for Securities Listing in the ASE*, Official Government Gazette A125/ 04.07.1985, as amended by Law 3401/2005 (Official Government Gazette A257/ 17.10.2005).

[452] *See, e.g.*, HCMC Rule 2/258/ 05.12.2002 *on the Take-Over Code for Tender Offers in the Capital Market* (Take-Over Bid), Official Government Gazette B19/ 16.01.2003, which abolishes the HCMC Rule 1/195/19.07.2000, Official Government Gazette B1030/ 22.08.2000), which is combined with the Hellenic Law 2733/1999 (*see, e.g.*, Law 2733/1999

The enactment of these Codes of Conduct of business was part of the incorporation process of the European legislation into the Greek legal order. In practice, the responsibility for the monitoring of compliance with the codes of conduct rests with the HCMC, which pursuant to the provisions of the Law 2836/2000,[453] is endowed with the authority to impose administrative sanctions (such as suspension and revocation of license, trading halts, imposition of fines) on all supervised legal and physical entities that violate capital market law and the rules. It is also endowed with the authority to submit indictments to prosecution authorities when punishable financial law violations are detected.

Interestingly, all five codes of conduct are combined with previous legislation to enforce securities and capital markets rules, governing, particularly, publicly traded companies. This fact explains the following observations. First, the tendency of the regulator to legislate is confirmed. On this account, the corporate governance framework is transformed to a rigid and inflexible one, which further explains, at least in part, the second observation, namely the weak compliance at firms' level. Such situation is a status quo and the HCMC is aware of that, which partially explains why the HCMC permits (or even encourages to some certain extent) that the voluntary codes of best practices are further strengthened, (i.e. to become compulsory),

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on the Development of New Market in the ASE, General Amendments of the Capital Market, the Public Companies and Organizations, the Corinth Canal SA and Other Provisions', Official Government Gazette A155/ 30.07.1999, as last amended by Law 3152/2003, Official Government Gazette A152/ 19.06.2003), and the Hellenic Law 1969/1991 (*see, e.g.*, Hellenic Law 1969/1991 *on Portfolio Investment Companies, Mutual Funds and Other Provisions Aiming at the Modernisation and Improvement of the Hellenic Capital Market Commission*, Official Government Gazette A167/ 30.10.1991, as last amended by Law 3371/2005 *on HCMC issues and other provisions*, Official Government Gazette A178/ 14.07.2005).

[453] *See, e.g.*, Hellenic Law 2836/2000 *on Completion of Hellenic Capital Market Commission Regulation, Amendments Concerning the Public Real Estate Company, Insurance Compensations, Value Added Tax, Investing Gold and Other Provisions'*, Official Government Gazette A168/ 24.07.2000, as last amended by Law 3371/2005 (Official Government Gazette A178/ 14.07.2005).

when they are introduced at the same time by means of legislation. Such weak compliance is also testified in the analysis of the following chapter.

Third, it is confirmed that the Greek corporate governance universe entails regulatory repetition and overlaps, since some best practices are also binding provisions in legislation. This creates confusion to the extent that from the one side corporations are encouraged from the codes to apply the recommendations and to be informed of them for ensuring business development and better protection of shareholders' rights, yet on the other side legislation on the same issue demands compliance. Furthermore, overlaps undermine the coherence and efficiency of the legal framework, and increase operational costs for corporations.

Overall, from the above codes, which all represent a major contribution to the enhancement of transparency and disclosure regarding the behaviour of listed companies in the capital market, particular corporate governance overlaps have been noted with respect to key provisions of the code of conduct for listed companies.[454]

In general, the Code of Conduct for listed companies, aiming to eliminate uncertainty in the market about corporate affairs, sets behaviour standards for all ASE listed companies; their major shareholders; members of the board of directors; executive managers with specific responsibilities; and other persons or associated companies, which are directly or indirectly related to those listed companies. The fact that the key provisions of this Code are also reiterated by the Articles 2-5 of the Corporate Governance Law of 2002,

[454] *See, e.g.,* HCMC Rule 5/204/14.11.2000 *on the Code of Conduct for Companies Listed on the Athens Stock Exchange and Connected Persons'*, Official Government Gazette B1487/ 06.12.2000, as amended by HCMC Decisions 3/348/2005, Official Government Gazette B1081/ 01.08.2005, and 7/372/15.02.2006 *on Amendment of HCMC Rule 5/204/14.11.2000*, Official Government Gazette B247/ 27.02.2006.

as is analysed in more detail below, explains the existing regulatory overlaps and confirms the main proposition with regard to the creation of an overly bureaucratic legal framework.

More particularly, this Code recognises the dissemination of reliable and timely information for important corporate events that shall be taken to be the most efficient way for the elimination of speculation by company insiders or other persons that may have inside information and the distortion of share prices as a result of misleading information and unsubstantiated rumours. The Code specifies all corporate actions that must be in a timely fashion announced and explicitly verified and requires that all listed companies form a corporate announcements department. A similar approach is adopted in the Corporate Governance Law of 2002 that stipulates in article 6 paragraphs (d) and (e) the establishment of adequate procedures for monitoring transactions made by board members, management, and persons who due to their specific post in the company have internal information and the establishment of a procedure to announce and notify the public of important company-related transactions and other economic activities of the Board members or third parties to whom responsibilities of the Board of Directors have been granted, as well as transactions with main clients or suppliers.[455]

Additionally, all listed companies are required to form an internal audit department, which is also reiterated by article 7 of the Corporate Governance Law of 2002. On disclosure matters, all listed companies are also obliged to publish an Annual Report, the content of which will bear close resemblance to the content of company Prospectus, as provided by

[455] *See, e.g.,* Hellenic Law 3016/2002 *on Corporate Governance, Board Remuneration and Other Issues,* Official Government Gazette 110/ 17.05.2002, as amended by Law 3091/2002, (Official Government Gazette A330/ 24.12.2002), Article 6, paragraph 2.

Presidential Decree 348/1985.[456] An important contribution to financial disclosure practices is the requirement to publish in the Annual Report a cash flow statement, which will allow the efficient monitoring of both company cash flows (and consequently their level of liquidity) and the uses of funds raised through share capital increases.[457] Resembling the prospectus that companies shall submit to get approval of their application for an initial public offering is the Internal Regulation that companies are obliged to prepare pursuant to article 6 of the Corporate Governance Law of 2002.[458] Here, the effect of overlapping regulations is the creation of more obligations to companies than actually needed therefore increasing compliance and operational costs.

The EU and the OECD Legal Principles

General Remarks

Furthermore, in an attempt to demonstrate the pervasive impact of international and European standards in the formation of the Greek corporate governance universe, two important sources of law are described. First, there is EU legislation that has introduced important corporate governance requirements through implementation of EC capital market law in the

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[456] *See, e.g.,* Presidential Decree 348/1985 *on Determination of Conditions for the Edition, Audit and Publication of the Prospectus to be Published for Securities Listing in the ASE,* Official Government Gazette A125/ 04.07.1985, as amended by Law 3401/2005 (Official Government Gazette A257/ 17.10.2005).

[457] The cash flow statement is structured along International Accounting Standards (IAS) and constitutes the first step of implementing IAS in Greece.

[458] *See, e.g.,* Hellenic Law 3016/2002 *on Corporate Governance, Board Remuneration and Other Issues,* Official Government Gazette 110/ 17.05.2002, as amended by Law 3091/2002, (Official Government Gazette A330/ 24.12.2002), Article 6, paragraph 1.

domestic legal orders of member states.[459] Second, there are the OECD Corporate Governance Principles that have brought in important developments in the Greek corporate governance regime.

Such discussion reveals three important issues. First, these two sources of law are significant for determining the Greek corporate governance universe, given that, particularly with respect to the EU legal principles, the Greek regulator tends to closely follow the developments in the EU legislation. Failing to discuss the impact of those sources would be tantamount to disregarding two important factors explaining regulatory initiatives. Second, these two sources of law possess a prominent position in the Greek legal order since they are binding legal principles. Third, the tendency of the Greek regulator is to legislate on corporate governance matters, therefore confirming the nature of the Greek rules-based corporate governance system.

The EC Capital Market Law

The EC capital market law, as one important branch of the European financial law, has significantly impacted on the shaping of the Greek

[459] For the purposes of better understanding the following analysis of the main EC regulatory initiatives, it is deemed necessary to briefly explain the new EC law making procedure. The time-consuming procedure of the implementation of EU Directives was a significant obstacle in the achievement of the tight timeframe for the implementation of the Financial Services Action Plan (FSAP) measures. Against this background, a Committee of Wise Men was appointed, chaired by Baron Alexandre Lamfalussy, to address this issue. The Committee in its final report (15 February 2001) recommended a tiered decision making process for EU legislation, the so-called Lamfalussy process. The introduction of new legislative techniques proposed was based on a four-level approach, namely framework principles, implementing measures, cooperation and enforcement. Level 1, the directive, should confine itself to broad, general 'framework' principles and the definition of Commission implementing powers, while Level 2 should contain technical implementing measures for adopting level 1 framework principles, which should be agreed at a second level by the Commission and Member States' experts under the so-called 'comitology' procedure. Level 3 and 4 of the Lamfalussy procedure cover *supervision* of Member States *implementation* of the Directives.

corporate and capital market landscape, and has an omnipresent influence on corporate governance principles. More particularly, the EC capital market law contains provisions by means of which the following objectives are, *inter alia*, sought. First, it is the ensuring of the efficiency of the capital market. Second, it is the ensuring of the stability of the capital market.

For the purposes of ensuring the efficiency of the capital market, the European Council and the Commission have issued Directives and Regulations to govern the issues of market abuse (including its two main branches, namely market manipulation and insider dealing), transparency, and listing requirements.

In the area of market abuse, the EU has produced a comprehensive set of legal principles, recognising in that way the importance of mitigating market manipulation and insider dealing activities in order to ensure the integrity of community financial markets and to enhance investor confidence in those markets.[460] EC Directive 2003/6 (known as the Market Abuse Directive) is the key legal document in that regard, which has been associated with three more directives and one regulation.[461] The Directive is based on the

[460] *See, e.g.*, Council Directive (EC) 2003/6 of 28 January 2003 on insider dealing and market manipulation (market abuse) [2003] OJ L96/16 (the Market Abuse Directive), preamble item 12.

[461] *See, e.g.*, Council Directive (EC) 2003/6 of 28 January 2003 on insider dealing and market manipulation (market abuse) [2003] OJ L96/16 (the Market Abuse Directive). On the law making process, it is recalled that the Commission adopted four Level 2 acts implementing the Market Abuse Directive: three directives (a) Commission Directive (EC) 2003/124 of 22 December 2003 implementing Council Directive (EC) 2003/6 as regards the definition of public disclosure of inside information and the definition of market manipulation, [2003] OJ L339/70; (b) Commission Directive (EC) 2003/125 of 22 December 2003 implementing Council Directive (EC) 2003/6 as regards the fair presentation of investment recommendations and the disclosure of conflicts of interest, [2003] OJ L339/73; and (c) Commission Directive (EC) 2004/72 of 29 April 2004 implementing Council Directive (EC) 2003/6 as regards accepted market practices, the definition of insider trading in relation to derivatives and commodities, the drawing up of lists of insiders, the notification of managers' transactions and the notification of suspicious transactions, [2004] OJ L162/70 and one Regulation, e.g. Commission Regulation (EC) 2273/2003 of 22 December 2003 implementing Council Directive (EC) 2003/6 as regards exemptions for buy-back programmes and

principles of transparency and equal treatment of market participants and requires closer cooperation and a higher degree of exchange of information between national competent authorities. This Directive is a cornerstone of EU legislation in that it has reduced to some certain extent potential inconsistencies, confusion, and loopholes by establishing a framework for the allocation of responsibilities, enforcement and cooperation within the Community.

Following the developments in the EU legislation, the market abuse legal framework in Greece has been greatly strengthened by the enactment of the Law 3340/2005,[462] which transposes into the domestic market the Market Abuse Directive. In addition, the role of the HCMC has been significant to the extent that it has issued a number of decisions to transpose the level 2 directives imposing the market abuse directive.[463]

However, at this point it is important to note that the Greek regulator, although not explicitly deriving from the EC obligations, decided to treat all

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stabilisation of financial instruments, [2003] OJ L336/33. The Level 2 Regulation entered into force on the day of its publication in the Official Journal (23.12.2003).

[462] *See, e.g.,* Hellenic Law 3340/2005 *on the Protection of the Hellenic Capital Market Commission from Insider Dealing and Market Manipulation (Market Abuse),* Official Government Gazette A112/ 10.05.2005.

[463] (a) The HCMC Decision 1/347/12.7.2005 on market abuse typology, (Official Government Gazette B983/13.7.2005) and HCMC Decision 3/347/12.7.2005 on issuers obligations to disclose inside information, (Official Government Gazette B983/13.7.2005) introduce to the Greek capital market the provisions of the Commission Directive (EC) 2003/124 of 22 December 2003 implementing Council Directive (EC) 2003/6 as regards the definition of public disclosure of inside information and the definition of market manipulation, [2003] OJ L339/70; (b) the HCMC Decision 4/347/12.7.2005 on the obligations of financial analysts, (Official Government Gazette B983/13.7.2005) transposes the Commission Directive (EC) 2003/125 of 22 December 2003 implementing Council Directive (EC) 2003/6 as regards the fair presentation of investment recommendations and the disclosure of conflicts of interest, [2003] OJ L339/73; and (c) the HCMC Decision 2/347/12.7.2005 on the obligations of persons that due to their post conduct transactions, in relation to the prevention of market abuse practices, (Official Government Gazette B983/13.7.2005), the HCMC Decision 3/347/12.7.2005 on issuers obligations to disclose inside information, (Official Government Gazette B983/13.7.2005), and the HCMC Decision 5/347/12.7.2005 on the procedure and the criteria for acceptable market practices, (Official Government Gazette B983/13.7.2005) transpose Commission Directive (EC) 2004/72 of 29 April 2004 implementing Council Directive (EC) 2003/6 as regards accepted market practices, the definition of insider trading in relation to derivatives and commodities, the drawing up of lists of insiders, the notification of managers' transactions and the notification of suspicious transactions, [2004] OJ L162/70.

market abuse acts (e.g., market manipulation and insider dealing) as criminal offences and as such severe penalties are stipulated by the Greek Penal Code and other penal laws.[464]

To continue with the objective of EC capital market law to ensure transparency for investors, the European Parliament and the Council have issued the so-called Transparency Directive, which deals with financial reporting requirements, disclosure of interests in securities, and communications with holders of shares and debt securities and the market.[465] This Directive aims to enhance investor protection, to attract investors to the European market place, and to improve the efficiency, openness and integrity of European capital markets. In addition, it also removes certain national barriers linked to transparency requirements, which may discourage issuers from having their securities admitted to trading on more that one regulated market in the EU. The Directive upgrades the current level and frequency of the mandatory financial information that issuers have to provide to the markets throughout the financial year.

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[464] The legal framework for the elimination of market abuse acts has been further strengthened with the recently enacted Hellenic Law 3424/2005 *amending Law 2331/1995 and implementing Council Directive (EC) 2001/97 on prevention of the use of the financial system for the purpose of money laundering,* (Official Government Gazette A305/ 13.12.2005) that incorporates into domestic legal order the Council Directive (EEC) 1991/308 OJ L166/77, as amended by Council Directive (EC) 2001/97 OJ L344/76 (Council Directives (EEC) 1991/308 of 10 June 1991 on prevention of the use of the financial system for the purpose of money laundering [1991] OJ L166/77, as amended by Council Directive (EC) 2001/97 of 4 December 2001 [2001] OJ L344/76) and the revised 40 Financial Action Task Force (FATF) Recommendations (2003), and part of the 9 Special FATF Recommendations. Pursuant to Article 2 (i) (p) 'market abuse acts are considered to be predicate offences and as such they can bring penal fines and restrictions'.

[465] *See, e.g.,* Council Directive (EC) 2004/109 of 15 December 2004 on the harmonisation of transparency requirements in relation to information about issuers whose securities are admitted to trading on a regulated market and amending Council Directive (EC) 2001/34 [2004] OJ L390/38 (the Transparency Directive).

The effects of this Directive, along with the Investment Services Directive[466], as it has been considerably amended by the Markets in Financial Instruments Directive (MiFID),[467] have been pervasive to the Greek legal order to the extent that more comprehensive financial reports for issuers of shares admitted to trading on a regulated market have been introduced. Such development is positive since it allows investors to make a more informed assessment of the issuer's situation.

The Transparency Directive has been transposed into the Greek capital market law by the enactment of the Law 3556/2007[468] and prior to that the Law Hellenic Law 2396/1996[469] transposed the main provisions of the Investment Services Directive. Moreover, the regulatory intervention of the HCMC has been significant for the transposition of the level 2 implementing measures for the purposes of which three important decisions have been published that further strengthen the regulatory framework on ensuring the regular flow of information to investors.[470]

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[466] *See, e.g.,* Council Directive (EEC) 1993/22 of 10 May 1993 on Investment Services in the Securities Field [1993] OJ L141/27.

[467] *See, e.g.,* Council Directive (EC) 2004/39 of 21 April 2004 on markets in financial instruments amending Council Directives (EEC) 85/611 and 93/6 and Directive (EC) 2000/12 and repealing Council (EEC) 93/22 [2004] OJ L145/1. It is important to note that MiFID is expected to bring about important changes to the Greek capital market legal framework and has been recently transposed into the Greek legal order by the Hellenic Law 3606/2007 *on markets in financial instruments,* Official Government Gazette A195/17.08.2007.

[468] *See, e.g.,* Hellenic Law 3556/2007 *on the transparency requirements in relation to information about issuers whose securities are admitted to trading on a regulated market,* Official Government Gazette A91/30.04.2007.

[469] *See, e.g.,* Hellenic Law 2396/1996 *on Investment Services in the Securities Field, Capital Adequacy of Investment Services Firms and Credit Institutions and Shares' Dematerialisation,* Official Government Gazette A73/ 30.04.1996, as last amended by Law 3371/2005 (Official Government Gazette A178/ 14.07.2005).

[470] The level-2 measures of the Transparency Directive have been introduced by the following HCMC Decisions: (a) HCMC Decision 1/434/3.7.2007 on the specification of ongoing and periodic information requirements pursuant to the Law 3556/2007 (Official Government Gazette B1222/17.7.2007); (b) HCMC Decision 6/448/11.10.2007 on information and data included in the quarterly and semi-annual financial reports (Official Government Gazette B2092/29.10.2007); and (c) HCMC Decision 7/448/11.10.2007 on additional information and data included in the annual and semi-annual financial reports (Official Government Gazette B2092/29.10.2007).

Furthermore, the Prospectus Directive, and its level 2 implementing measures, represents an essential instrument for ensuring investor protection and market efficiency (mainly through establishing the principle of the single passport to the issuer) in accordance with high regulatory standards adopted in the relevant international fora.[471] The new regime for prospectuses is the centrepiece of the new disclosure framework. It allows firms to organise European-wide capital-raising exercises on the basis of a single document. Essentially, this Directive introduces a new 'single passport for issuers' so that once a prospectus had been approved by the home country authority of the issuer, it has to be accepted throughout the EU for public offer and/or admission to trading on regulated markets. The Directive makes the whole system for prospectuses much simpler and operational and so makes it easier and cheaper to raise capital throughout the EU.

The effect of this EC regulatory initiative for the progress of the Greek capital market legislation is all-pervading, since the Greek regulator, like other European regulators, has closely followed the developments of European legislation by enacting the Law 3401/2005[472] and the HCMC has issued relevant decision applicable to all listed companies on the ASE.[473] Therefore, this legislative framework envisages, *inter alia*, the obligation of companies to issue a prospectus when securities are offered to the public or admitted to trading, the obligation to publish reliable information at least on an annual basis, the publication of consistent and easily understandable

[471] *See, e.g.,* Council Directive (EC) 2003/71 of 4 November 2003 on the prospectus to be published when securities are offered to the public or admitted to trading and amending Council Directive (EC) 2001/34 [2003] OJ L345/64 (The Prospectus Directive).
[472] *See, e.g.,* Hellenic Law 3401/2005 *on the Prospectus to be Published when Securities are Offered to the Public or Admitted to Trading,* Official Government Gazette A257/ 17.10.2005.
[473] *See, e.g.,* HCMC Decision 3/398/22.9.2006 on the procedure and the requirements for prospectus' approval (Official Government Gazette B1566/25.10.2006).

information on a regular basis, and means to facilitate the circulation of the various information and documents and encourage the use of electronic communication facilities, such as the Internet.

Accordingly, the discussion of the EC law making initiatives that aim at ensuring the stability of the capital market reveals the significant effects of the MiFID (modernising the previous Investment Services Directive[474]). The recent implementation of the MiFID appears to have omnipresent effect within the context of the EC capital market to the extent that it contains provisions addressing, *inter alia,* issues relating to the sound operation of capital markets, the granting of license and operation of investment companies, credit institutions, and Undertakings for Collective Investments in Transferable Securities (UCITS), the withdrawal of authorisation, the capital adequacy requirements, and general prudential supervision matters.

Although the scope of the present analysis is limited to describe mainly the effects of the EC legislation, it cannot extend to discussing in detail the changes that the MiFID is about to bring in the Greek legal order (and to a similar extent to other member states' market). Briefly, beyond the substantial IT upgrading and the review of contracts with clients and data suppliers that firms will have to make in order to classify them in one of the three categories (e.g. retail client, professional client, or eligible counterpart), the important change that the new regime brings is that there will be no regulated exchange with a 'de facto' monopoly of trading for a certain financial instrument in a certain jurisdiction. Although the latter is expected to foster competition and a level playing field between EU trading venues, it is

[474] *See, e.g.,* Council Directive (EEC) 1993/22 of 10 May 1993 on Investment Services in the Securities Field [1993] OJ L141/27.

important to bear in mind that the creation of many market operators will require that the overall operational and technology structure of firms must have sufficient capacity and flexibility to include them as they occur.[475] Finally, an important change introduced by MiFID relates to the transformation of the concept of 'Best Execution', since it moves away from the traditional simple 'best price' (e.g. lowest bid, highest offer) towards 'best possible outcome at lowest possible costs'.[476]

Notwithstanding that MiFID represents an opportunity for firms to consider how they wish to conduct business across Europe in the future and offers a chance to create an integrated, highly efficient business model to deliver maximum business advantage, the transition towards implementing the new regime is a serious quest. There are substantial conceptual differences and significant practical implications, which excuse the quite late transposition from the Greek regulatory authorities. MiFID has been recently incorporated in the Greek legal order by the Law 3606/2007.[477] In addition, the Greek capital market framework has been substantially strengthened with the enactment of the Law 2396/1996,[478] as amended, that governs the investment services in the securities field and is the result of transposing the Investment Service Directive.[479]

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[475] *See, e.g.,* Mertzanis, H. V., 'The Markets in Financial Instruments Directive (MiFID): Multiple Trading Venues and Best Execution' (presentation to the Hellenic Capital Market Commission, Athens, 25 September 2007).
[476] *Id.*.
[477] *See, e.g.,* Hellenic Law 3606/2007 *on markets in financial instruments*, Official Government Gazette A195/17.08.2007.
[478] *See, e.g.,* Hellenic Law 2396/1996 *on Investment Services in the Securities Field, Capital Adequacy of Investment Services Firms and Credit Institutions and Shares' Dematerialisation,* Official Government Gazette A73/ 30.04.1996, as last amended by Law 3371/2005 (Official Government Gazette A178/ 14.07.2005).
[479] *See, e.g.,* Council Directive (EEC) 1993/22 of 10 May 1993 on Investment Services in the Securities Field [1993] OJ L141/27.

Overall, while the new regime is expected to bring about fundamental changes in the Greek capital market, as aforementioned, Greek market participants are still not comfortable enough with MiFID's overly technical requirements. Besides, such regulatory changes will enable the Greek market to further develop into a more mature and efficient market, where investors (foreign and domestic) can enjoy legal and regulatory certainty.

Finally, another important development in EC legislation that has significant effects on the Greek capital market and corporate governance universe by modifying the way that corporations operate, relates to requirements on financial statements and most importantly the introduction of the International Financial Reporting Standards (IFRS).

More particularly, all listed companies on the Athens Stock Exchange (ASE) are required to comply with the provisions of the Presidential Decree 350/1985,[480] which brings into the Greek law the Council Directive (EEC) 79/279.[481] According to this Presidential Decree, the companies, whose shares are listed on the ASE, have certain obligations as regards the annual financial statements and the publication of management reports. The company places at the disposal of the public, as soon as possible, its last annual financial statements and the last management report. If the company draws up together with the unconsolidated financial statements the consolidated ones, it places them at the disposal of the public.

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[480] *See, e.g.*, Presidential Decree 350/1985 *on Listing Requirements in the Athens Stock Exchange and Issuers' Duties and Obligations*, Official Government Gazette A126/ 04.07.1985, as last amended by Law, as last amended by Law 3401/2005 (Official Government Gazette A257/ 17.10.2005).

[481] *See, e.g.*, Council Directive (EEC) 1979/279 of 5 March 1979 Coordinating the Conditions for the Admission of Securities to Official Stock Exchange Listing [1979] OJ L066/21.

On 19 July 2002, the European Parliament and the Council adopted the Regulation (EC) 1606/2002 'on the application of International Accounting Standards'.[482] The Regulation has as its objective the adoption and use of international accounting standards in the Community with a view to harmonise the financial information presented by corporations in order to ensure a high degree of transparency and compatibility of financial statements and hence an efficient function of the Community capital market and of the Internal Market.

Against this background, the Greek regulator passed the Law 2992/2002,[483] and most recently the Laws 3229/2004[484] and 3301/2004,[485] which introduced into the Greek legislation the new IAS/IFRS. Consequently, as of 1 January 2005, all Greek listed companies are obliged to apply in their financial statements the new IAS/IFRS standards, the compilation and publication of which will be made according to the provisions of the aforementioned Laws. This reflects a milestone for transparency and efficient compatibility of accounts among different types of companies, since financial statements of all Greek listed companies will become directly and easily comparable with those of publicly traded entities in all other euro zone countries.

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[482] *See, e.g.*, Council Regulation (EC) 1606/2002 of 19 July 2002 on the application of International Accounting Standards (IAS) [2002] OJ L243/1 (the IAS Regulation).
[483] *See, e.g.*, Hellenic Law 2992/2002 *on Measures on Capital Market Enhancement and Other Provisions*, Official Government Gazette A54/ 20.03.2002, as last amended by Law 3371/2005 (Official Government Gazette A178/ 14.07.2005).
[484] *See, e.g.*, Hellenic Law 3229/2004 *on Supervision of Private Insurance and Controls on Lucky Games, Application of the International Accounting Standards and Other Provisions*, Official Government Gazette A38/ 10.02.2004, as last amended by Law 3427/2005 (Official Government Gazette A312/ 27.12.2005).
[485] *See, e.g.*, Hellenic Law 3301/2004 *on the Application of the International Accounting Standards (IAS)*, Official Government Gazette A263/ 23.12.2004.

The OECD Corporate Governance Principles

Following the discussion of the impact of EC capital market law in the Greek legal order, the focus of the analysis now shifts to argue for the prominent position of the OECD Corporate Governance Principles for the shaping of the Greek corporate governance universe. A first testament of that is the publication of the 'Mertzanis Report', which in substance represents a translation of the OECD Principles.[486] Secondly, the fact that in view of the OECD Principles, a number of legislative improvements took place in the Greek securities markets, which in addition sketches the Greek rules-based corporate governance system.

To start with, *Principle One* declares the importance of effective corporate governance framework as a means to promote transparent and efficient markets and is determined that the corporate governance framework should be developed with a view to its impact on overall economic performance, market integrity, and the incentives that it creates for market participants. This Principle is mainly incorporated into the Greek legal order by Law 3371/2005,[487] which determines the basic preconditions to be met when securities are admitted to trading on the ASE. Pursuant to Article 10 paragraph 2, the ASE may refuse to accept an application for securities to be traded on the ASE, if it considers that market's efficient operation or investors' rights are somehow adversely affected, albeit other legal or regulatory conditions are met. Whereas Article 17, paragraphs 1 and 2 empowers the ASE with the authority to postpone the trading of some

[486] *See, e.g.*, Committee on Corporate Governance in Greece (under the coordination of the HCMC) 'Principles on Corporate Governance in Greece: Recommendations for its Competitive Transformation' (The Mertzanis Report) 1999 Athens, Greece *Cf.*, OECD (2004) 'OECD Principles of Corporate Governance'.

[487] *See, e.g.*, Hellenic Law 3371/2005 *Regarding Issues of the Hellenic Capital Market Commission*, Official Government Gazette A178/ 14.07.2005.

securities on the fear of endangering market integrity and efficiency, the HCMC assumes broader responsibility (paragraph 3) in the sense that it can even order, under specific circumstances, the deletion of the securities from being traded on the ASE. Hence, it appears that the Greek legislators have developed a concrete legal framework to accommodate Principle One.

Principle Two defines the most essential rights of shareholders and key ownership functions, whose exercise should be protected and facilitated by the corporate governance framework of Principle One. Article 11, paragraph 1 of the Law 3371/2005,[488] introduces that Principle by securing, *inter alia*, shareholders' right to participate in, and to be sufficiently informed on, decisions concerning fundamental corporate changes, and by requiring companies to provide the necessary facilitations in the exercise of shareholders' rights and make announcements regarding share capital increase (paragraph 3). The latter is also envisaged in Article 9 of the Corporate Governance Law of 2002.[489]

This framework for the protection of shareholders' rights is supplemented by Articles 4 and 5 of the HCMC Code of Conduct for listed companies that mandate the obligation of listed companies to timely provide accurate and true information to shareholders.[490] In addition, this provision stipulates the setting up of a special department, the Investors' Relations

[488] *See, e.g.,* Hellenic Law 3371/2005 *Regarding Issues of the Hellenic Capital Market Commission*, Official Government Gazette A178/ 14.07.2005.
[489] *See, e.g.,* Hellenic Law 3016/2002 *on Corporate Governance, Board Remuneration and Other Issues*, Official Government Gazette 110/ 17.05.2002, as amended by Law 3091/2002, (Official Government Gazette A330/ 24.12.2002).
[490] *See, e.g.,* HCMC Rule 5/204/14.11.2000 *on the Code of Conduct for Companies Listed on the Athens Stock Exchange and Connected Persons'*, Official Government Gazette B1487/ 06.12.2000, as amended by HCMC Decisions 3/348/2005 (Official Government Gazette B1081/ 01.08.2005) and 7/372/15.02.2006 *on Amendment of HCMC Rule 5/204/14.11.2000* (Official Government Gazette B247/ 27.02.2006).

Department, within the company, responsible for the dissemination of corporate information.

Principle Three is divided into two different parts with *part one* to refer to the equitable treatment of shareholders, in the sense that companies ensure that all shareholders have the opportunity to obtain effective redress for violation of their rights. Subsequently, *part two* concerns the insider trading and abusive self-dealing activities. With regard to the equitable treatment of shareholders, Article 11 paragraph 1 (a) of the Law 3371/2005[491] describes the relevant obligation and Article 6 of the HCMC Code of Conduct for listed companies specifies the sanctions that shall be imposed in case of breach of the companies' obligation to equally treat shareholders.[492]

Accordingly, insider dealing and market manipulation activities are prohibited by Articles 3-9 of the Law 3340/2005,[493] which incorporate into the domestic legal order the Market Abuse Directive, as aforementioned.[494] These provisions sketch an integrated framework for insider dealing imposing a number of obligations to listed companies and other persons with access to 'privileged information' *vis-à-vis* confidential information. In a similar vein, the Corporate Governance Law of 2002 addresses the issue of conflicts of interests, as provided for by Article 2 paragraph 3, by obliging Members of the Board of Directors to disclose in due course to the other members of the

[491] *See, e.g.,* Hellenic Law 3371/2005·*Regarding Issues of the Hellenic Capital Market Commission*, Official Government Gazette A178/ 14.07.2005.
[492] *See, e.g.,* HCMC Rule 5/204/14.11.2000 *on the Code of Conduct for Companies Listed on the Athens Stock Exchange and Connected Persons'*, Official Government Gazette B1487/ 06.12.2000, as amended by HCMC Decisions 3/348/2005 (Official Government Gazette B1081/ 01.08.2005) and 7/372/15.02.2006 *on Amendment of HCMC Rule 5/204/14.11.2000* (Official Government Gazette B247/ 27.02.2006).
[493] Articles 3-6 refer to the insider dealing practices and Articles 7-9 cover the market manipulation practices. *See, e.g.,* Hellenic Law 3340/2005 *on the Protection of the Hellenic Capital Market Commission from Insider Dealing and Market Manipulation (Market Abuse)*, Official Government Gazette A112/ 10.05.2005.
[494] *See, e.g.,* Council Directive (EC) 2003/6 of 28 January 2003 on insider dealing and market manipulation (market abuse) [2003] OJ L96/16 (the Market Abuse Directive).

Board any own interests, which are likely to arise from transactions of the company falling within their competences.[495] The HCMC, pursuant to Articles 21 and 22 of the Law 3340/2005 assumes the responsibility to safeguard the full implementation of the provisions of the Law. At the same time, HCMC has increased supervisory and investigatory powers in order to establish a breach of the provisions. Finally, the sanctions and administrative fines that can be imposed are described in Articles 23-24 and 29-31 of the Law 3340/2005.

The *Fifth Principle* emphasizes the pressing need for disclosure and transparency in the interest of investors, who will be able to better monitor and evaluate corporations' performance. The fifth principle covers a wide range of information that also satisfies other OECD principles, such as for instance Principle two that refers to the shareholders' rights. The implementation of some of the main elements of the fifth principle has been declared by Law 3401/2005,[496] which in principle incorporates into the Greek legal order the Prospectus Directive,[497] as aforementioned, that aims to ensure investor protection and market efficiency.

The above legal framework is significantly supplemented by the HCMC Code of Conduct for listed companies[498] and the Law 3371/2005.[499]

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[495] *See, e.g.,* Hellenic Law 3016/2002 *on Corporate Governance, Board Remuneration and Other Issues,* Official Government Gazette 110/ 17.05.2002, as amended by Law 3091/2002, (Official Government Gazette A330/ 24.12.2002).

[496] *See, e.g.,* Hellenic Law 3401/2005 *on the Prospectus to be Published when Securities are Offered to the Public or Admitted to Trading,* Official Government Gazette A257/ 17.10.2005.

[497] *See, e.g.,* Council Directive (EC) 2003/71 of 4 November 2003 on the prospectus to be published when securities are offered to the public or admitted to trading and amending Council Directive (EC) 2001/34 [2003] OJ L345/64 (the Prospectus Directive).

[498] *See, e.g.,* HCMC Rule 5/204/14.11.2000 *on the Code of Conduct for Companies Listed on the Athens Stock Exchange and Connected Persons',* Official Government Gazette B1487/ 06.12.2000, as amended by HCMC Decisions 3/348/2005 (Official Government Gazette B1081/ 01.08.2005) and 7/372/15.02.2006 *on Amendment of HCMC Rule 5/204/14.11.2000* (Official Government Gazette B247/ 27.02.2006), at Articles 2 and 4.

The latter modernises the operation of the HCMC and includes fundamental provisions with regard to information to investors. More particularly, Article 11 paragraph 2 of the said Law stipulates that all listed companies shall disclose and make public to investors the annual consolidated financial statements without delay, along with management reports. Additionally, Articles 15 and 16 of the same Law underline and strengthen the role and powers of the HCMC and lay down the obligation of listed companies to provide any information that might be considered necessary by the HCMC in view of protecting investors and/or market efficiency.[500] Finally, the central role of the Athens Stock Exchange (ASE) is secured by virtue of Article 285 of the Athens Exchange Rulebook, according to which 'issuing companies must provide the Athens Exchange with all information requested by the latter in its capacity as administrator of a regulated market and in the framework of its role as a mechanism for the dissemination of information to the public, with the aim of protecting the investing public or ensuring the smooth operation of Athens Exchange.[501]

Furthermore, the information that shall be disclosed, as outlined in the *fifth principle*, is also stipulated by the provisions of the Law 3301/2004,[502] which imposes the application of the International Accounting Standards / International Financial Reporting Standards (IAS / IFRS), in compliance with Council Regulation (EC) 1606/2002[503] and the Presidential Decree

[499] *See, e.g.,* Hellenic Law 3371/2005 *Regarding Issues of the Hellenic Capital Market Commission*, Official Government Gazette A178/ 14.07.2005.
[500] The latter is in strong correlation with the OECD *Principle One*, as described above.
[501] *See, e.g.,* Athens Exchange Rulebook – Listing and Trading, 7th Edition (25 October 2007).
[502] *See, e.g.,* Hellenic Law 3301/2004 *on the Application of the International Accounting Standards (IAS)*, Official Government Gazette A263/ 23.12.2004.
[503] *See, e.g.,* Council Regulation (EC) 1606/2002 of 19 July 2002 on the application of International Accounting Standards (IAS) [2002] OJ L243/1 (the IAS Regulation).

360/1985,[504] which refers to the publication of financial statements on companies' web site.

Principle Six acknowledges that the corporate governance framework shall ensure the strategic guidance of the company, the effective monitoring of management by the board and the board's accountability to the company and the shareholders. Overall, the provisions of the Corporate Governance Law of 2002 address the key objective sought from this Principle.[505]

Therefore, from the above discussion it is evident that the OECD Corporate Governance Principles are largely incorporated into the Greek legal order by means of binding legislation. The binding nature of those legislative texts reflects the rule-based approach of Greek legislators to regulating the area of corporate governance. The ultimate challenge of Greek markets is not merely to implement corporate governance principles, but most importantly to ensure their full internalisation. The next chapter will address this issue.

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[504] *See, e.g.,* Presidential Decree 360/1985 *on Financial Information to be Published Periodically by Companies Listed in the ASE,* Official Government Gazette A129/ 09.07.1985, as last amended by Law 3371/2005 (Official Government Gazette A178/ 14.07.2005).

[505] *See, e.g.,* Hellenic Law 3016/2002 *on Corporate Governance, Board Remuneration and Other Issues,* Official Government Gazette 110/ 17.05.2002, as amended by Law 3091/2002, (Official Government Gazette A330/ 24.12.2002).

CHAPTER 4

GREEK CORPORATE GOVERNANCE: COMPLIANCE AND EFFICIENCY

1. INTRODUCTORY REMARKS

The Purposes of this Chapter

Building on the previous discussion of the Greek corporate governance universe, this chapter's main objective is to discuss the recorded discrepancy between the objectives of the corporate governance standards, compliance, and governance efficiency. For this purpose the following analysis has two main dimensions. First, to study the level of compliance of Greek listed companies with the corporate governance standards, as documented by recent Corporate Governance Surveys. Second, building on the basis of the overall moderate level of compliance of Greek listed firms with the corporate governance requirements, the focus of the analysis shifts to further explore those country specific factors that have contributed to the aforementioned discrepancy.

Therefore, the present analysis goes beyond merely reviewing the contradiction, where Greece is a country, which besides the existence of a wide range of corporate governance obligations, its overall governance is not as efficient as the aims of the corporate governance rules, and best practice recommendations have designed it to be. It goes further by providing in-depth reasoning to explain this contradiction, which seems to be strongly associated with another paradox in that the Greek corporations fail to comply not only with the non binding corporate governance requirements, but also with the binding rules.

Against this backdrop, this chapter attempts to shed some light on the overall performance and efficiency of the Greek corporate governance system based primarily on two recent Corporate Governance Surveys that examine the corporate governance compliance. The fundamental contribution of this analysis is twofold. First, that this thesis is a full-length study that discusses the relationship between Greek corporate governance rules and the extent to which those are implemented, as documented by recent Corporate Governance Surveys. Most importantly, it mainly attempts, for the first time, to explain such relationship on accounts of country-specific attributes. Second, the examination of those factors that can circumscribe the achievement of the objectives and aims of the Greek corporate governance framework is important, in that realistic and effective suggestions for improvement are designed, to mitigate the specific corporate governance weaknesses in the Greek corporate structures.

The Structure of this Chapter

The chapter is structured as follows. First, for the purposes of this study, it is important to briefly determine those efficiency parameters upon which the latter governance assessment is undertaken. The central role of the Board of Directors in the Greek corporate governance framework explains the primary focus of the following assessment, which is centred on this corporate governance mechanism.

Second, the main conclusions on the overall efficiency of the Greek governance system are reviewed, based on the key findings of the two recent Corporate Governance Surveys conducted by Grant Thornton and the Athens University of Economics and Business in 2005 and in 2006.[506] Both surveys document significant findings for the level of the governance performance in the Greek system.

Alongside this review a brief comparison with the corporate governance compliance of UK public limited corporations takes place. This serves two main purposes. First, to reveal the importance of country- and governance-specific variables (such as for instance the family origins of Greek corporations as opposed to the diffuse shareholding ownership of UK corporations) in determining the overall performance of a country's governance system. Second, notwithstanding the different governance origins and attributes of the UK public limited corporations, the fact that the latter enjoy high levels of governance performance offers a good example for Greek corporations. Importantly, the present study does not imply that Greek companies should transplant the UK corporate governance practices, which is neither possible nor desirable. Its aim is rather to throw down a challenge to those charged with governance to truly embrace the spirit of the Greek corporate governance rules and international best practice and so ensure a better future for the Greek governance system.

Third, the moderate levels of compliance are particularly explained on account of certain country-specific conditions aiming to determine the extent to which such factors have affected the Greek governance performance. Such

[506] *See, e.g.,* Grant Thornton and the Athens University of Economics and Business, '*2005 Corporate Governance Survey*' (2005); and Grant Thornton and Athens University of Economics and Business, '*2006 Corporate Governance Survey*' (in Greek) (2006).

discussion enables those entrusted with promoting good corporate governance to better capture those situational variables in that more realistic proposals for improving governance efficiency to be made.

2. GOVERNANCE ASSESSMENT AND REGULATORY COMPLIANCE: THE GREEK EXPERIENCE

Introduction

The Corporate Governance Law of 2002, as analysed in the previous chapter, places the Board of Directors at the apex of the Greek corporate governance system. This further explains the scope of the following governance assessment that mainly covers the specific compliance issues around this important corporate governance mechanism. Therefore, a review of the following efficiency factors is undertaken: (a) the independence of the Board of Directors; (b) the presence of independent non executive members in the Board of Directors; (c) the existence of remuneration policy for board members; (d) the adoption of appropriate organisation and internal regulation; (e) the establishment of internal control and risk management systems; and (f) the participation of shareholders in the governance processes.

The Board of Directors

At a theoretical level, as described in the previous chapter, the one-tier system of the Greek Board of Directors' structure is opposed to the so-called dual or two-tier system, where there is clear distinction between managing and supervisory directors (e.g. Germany). The role of the Board of Directors is central in determining the efficiency of the Greek corporate governance system, as recognised by the Corporate Governance Law of 2002[507] and the Mertzanis Report,[508] in that it assumes the responsibility of ensuring the establishment of efficient governance rules.

More particularly, the Mertzanis Report stresses that the Board of Directors has the responsibility, *inter alia*, (i) to deal with the corporation's affairs exclusively in the interests of the corporation and its shareholders within the existing regulatory framework; (ii) to ensure the establishment of efficient governance rules and be accountable to the General Shareholders Meetings for its activities and performance; (iii) to set the corporation's long-term goals and make all strategic decisions; (iv) to make available all required sources for the achievement of strategic goals, the appointment, and the supervision of management.[509]

Although the Board of Directors stands at the apex of the Greek corporate governance system, yet in practice a 'paying lip service' to compliance with certain governance requirements has been demonstrated.[510] Essentially, a significant performance is required with regard to the Board of Directors, along with ensuring independence of highest levels of the Board of Directors. Therefore, in assessing the independence of the Board of Directors, as an important factor for the overall efficiency of the Greek governance system, the following conclusions are reached.

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[507] *See, e.g.,* Hellenic Law 3016/2002 *on Corporate Governance, Board Remuneration and Other Issues*, Official Government Gazette 110/ 17.05.2002 as amended by Law 3091/2002, (Official Government Gazette A330/ 24.12.2002).

[508] *See, e.g.,* Committee on Corporate Governance in Greece (under the coordination of the HCMC) 'Principles on Corporate Governance in Greece: Recommendations for its Competitive Transformation' (The Mertzanis Report) 1999 Athens, Greece.

[509] *Id.* at 7.

[510] *See, e.g.,* Grant Thornton and the Athens University of Economics and Business, *'2005 Corporate Governance Survey'* (2005), at 3.

According to the findings of the 2005 Corporate Governance Survey in about 9 out of 10 cases (86.4%), the Chairman of the Board of Directors holds executive responsibilities as well, and additionally 61.5% of the companies enquired fail to divide responsibilities at the head of the company.[511] A similar trend is noted in 2006, where in about 8 out of 10 companies (76.6%), the Chairman exercises executive responsibilities as well, and in 57.6% of the companies, the Chairman of the Board and the Chief Executive Officer (CEO) are either the same person or close relatives.[512] At this point is important to note that with regard to the separation of the roles of CEO and Chairman of the Board, the family origins of the Greek corporations can explain the trend of combining these two roles into a single person.

Notably, within a short period of time (from 2005 to 2006) a slight improvement of the Greek governance performance is recorded with regard to the clear division of duties and responsibilities at the highest level of the company (from 61.5 to 57.6%). However, it is important to note that the difference between the percentages of Greek and UK companies that separate the roles of CEO / Chairman remains significant (92.7% for UK corporations[513]). As aforementioned, such pattern prevails in Greek corporations due to their family origin and the personal character of firms, in

[511] *See, e.g.,* Grant Thornton and the Athens University of Economics and Business, *'2005 Corporate Governance Survey'* (2005), at 12.
[512] *See, e.g.,* Grant Thornton and Athens University of Economics and Business, *'2006 Corporate Governance Survey'* (in Greek) (2006), at 12.
[513] Specifically, according to the findings of the Fourth and Fifth FTSE 350 Corporate Governance Review, 93.1% and 92.7% of the UK companies separated the two roles, in 2005 and 2006, respectively. Essentially, this pattern of separating the roles of CEO / Chairman in the UK companies originates from the recommendation A.2 of the Combined Code, which states that *'there should be a clear division of responsibilities at the head of the company between the running of the board and the executive responsibility for running of the company's business.' See, e.g.,* Grant Thornton (UK), Risk Management Services, *'Fourth FTSE 350 Corporate Governance Review: Highlighting Trends in Compliance'* (2005), at 11; and Grant Thornton (UK), Risk Management Services, *'Fifth FTSE 350 Corporate Governance Review 2006: Highlighting Trends in Compliance'* (2006), at 14.

contrast with the diffuse shareholding structure of UK public limited corporations.

In a similar vein, the Greek companies are lagging dramatically behind the statistics of the UK companies with regard to transparency for the reasons of not complying. More particularly, according to the findings of the 2006 Corporate Governance Survey (which reflect a similar trend in the 2005 Corporate Governance Survey) the vast majority of the Greek corporations do not make use of the possibility to explain the reasons for non compliance with corporate governance rules.[514] On the contrary, there are very positive results on the level of explanation given by UK companies, which almost total compliance with the provisions of the Combined Code is shown. In 2006, 96% (90%, in 2005) of the UK companies provided at least some explanation as to the reasons for non compliance.[515]

The above findings with regard to the compliance of Greek corporations with the principle of 'comply or explain' give rise to the following considerations. First, such low compliance can be explained on the grounds that this principle is provided for by the Mertzanis Recommendations as an option for corporations to use and not as obligation. Second, the compliance at Greek corporations' level is poor in that they do not realise on their own that choosing to explain the reasons for deviating from the legal framework will further boost their governance efficiency. Three, the previous two observations are strongly associated with the small size of Greek

[514] *See, e.g.,* Grant Thornton and Athens University of Economics and Business, '*2006 Corporate Governance Survey*' (in Greek) (2006), at 7-8; and Grant Thornton and Athens University of Economics and Business, '*2005 Corporate Governance Survey*', (2005), at 7-8.
[515] *See, e.g.,* Grant Thornton (UK), Risk Management Services, '*Fourth FTSE 350 Corporate Governance Review: Highlighting Trends in Compliance*' (2005), at 7; and Grant Thornton (UK), Risk Management Services, '*Fifth FTSE 350 Corporate Governance Review 2006: Highlighting Trends in Compliance*' (2006), at 9.

corporations, which in turn makes the application of such an option expensive in that it creates additional administrative costs and workload, so corporations choose not to adopt.

To continue with additional indications that show that companies do not ensure full independence at the highest level (e.g. the Board of Directors) the following factors are assessed. First, when the Chairman and/or the CEO are at the same time the major shareholder.[516] According to the findings of the 2005 Corporate Governance Survey, it appears that in half of the cases, the Chairman and/or the CEO is at the same time the major shareholder.[517] The need for more independence at the highest levels of the company is evident also from the findings of the 2006 Corporate Governance Survey, where in 7 out of 10 companies the major shareholder is the CEO and/or the Chairman.[518] Such practice confirms the personal character of the formation of the Board of Directors of Greek corporations and it stresses the need for reform.

Second, the establishment of adequate mechanisms is needed to appraise the performance of the Board members, its committees, and its individual directors. Such principle has been developed by the revised Combined Code (UK), which considers the adoption of this principle as crucial for efficient governance.[519] Significantly, the UK statistics record that there has been an overall reduction in the number of companies, who gave no

[516] Major shareholder is defined here as the natural persons or legal entities that hold more than 3% of the company's shares.
[517] *See, e.g.,* Grant Thornton and Athens University of Economics and Business, '*2005 Corporate Governance Survey*', (2005), at 13.
[518] *See, e.g.,* Grant Thornton and Athens University of Economics and Business, '*2006 Corporate Governance Survey*' (in Greek) (2006), at 13.
[519] This is another principle introduced by the revised Code relating to performance evaluation and it states that '*the board should state in the annual report how performance evaluation of the board, its committees and its individual directors has been conducted*'. *See, e.g.,* Financial Reporting Council – (FRC), *'The Combined Code on Corporate Governance'* (2006) June, at A. 6.1.

disclosure at all on performance evaluation, and a greater number of companies (in 2006 40% from 31% the year before) provided 'more detail' than the bare minimum required by the code.[520]

Notwithstanding that there is no such requirement in Greek corporate governance, the levels of compliance with such international best practice reveals the extent to which Greek corporations truly embrace the essence of good governance. Unfortunately, as it appears from the findings of both the 2005 and 2006 Corporate Governance Surveys, only a minority of Greek corporations has established appropriate evaluation mechanisms and procedures to appraise the performance of the Board of Directors and individual directors (24.5% in 2005 and 41.5% on 2006).[521] Despite the recorded improvement, still the large majority of Greek corporations fall short of establishing performance evaluation procedures. This further contributes to the poor governance efficiency and the lack of independence at the highest level of corporations.

Third, the extent to which corporations have established procedures for facilitating Board members to exercise their duties and responsibilities is important. In this line, the recommendations of the Mertzanis Report recognise the importance of external consultants by urging corporations to establish procedures that would allow the Board of Directors to obtain advice by external advisors.[522] In this context, according to the findings of the 2006

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[520] *See, e.g.,* Grant Thornton (UK), Risk Management Services, *'Fourth FTSE 350 Corporate Governance Review: Highlighting Trends in Compliance'* (2005), at 12; and Grant Thornton (UK), Risk Management Services, *'Fifth FTSE 350 Corporate Governance Review 2006: Highlighting Trends in Compliance'* (2006), at 15.

[521] *See, e.g.,* Grant Thornton and the Athens University of Economics and Business, *'2005 Corporate Governance Survey'* (2005), at 14; and Grant Thornton and Athens University of Economics and Business, *'2006 Corporate Governance Survey'* (in Greek) (2006), at 14.

[522] *See, e.g.,* Committee on Corporate Governance in Greece (under the coordination of the HCMC) 'Principles on Corporate Governance in Greece: Recommendations for its

Corporate Governance Survey, almost 5 out of 10 companies (e.g. 47%) have established procedures for taking external advice,[523] which is considerably improved with that of 37.9% documented in 2005.[524]

It is estimated that this statistic will further increase in the following years given two important considerations. First is the tendency of Greek corporations to hire third parties for consultation projects. As Greek corporations' size will grow, so reliance on external advisors will increase. Second is the fact that in the Greek market there is a wide net of consultancy firms that are in position to offer 'cut and paste' advice packages, due to similarities between Greek corporations.

Fourth is the extent to which corporations encourage the effectiveness of the Board of Directors, in that board members are allowed to participate in affiliated or other companies. The findings of the 2005 Corporate Governance Survey reveal, which are at a similar range with the ones in 2006, that almost half of the members of the Board of Directors participate in the Board of affiliated or other companies.[525] Therefore, the phenomenon of the 'busy director' that is recorded in Greek corporations can be explained by the following reasons. First is the shallow Greek market and its small size that illuminates the lack of high level executives. Second is the absence of such a

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Competitive Transformation' (The Mertzanis Report) 1999 Athens, Greece, at 14, recommendation § 5.9.

[523] *See, e.g.,* Grant Thornton and Athens University of Economics and Business, '*2006 Corporate Governance Survey*' (in Greek) (2006), at 15.

[524] *See, e.g.,* Grant Thornton and the Athens University of Economics and Business, '*2005 Corporate Governance Survey*' (2005), at 15.

[525] In 2005, 41% (41.1% in 2006) of the companies' Board members participated in the Board of Directors of affiliated companies and 47.4 % (51.2% in 2006) of other companies. *See, e.g.,* Grant Thornton and the Athens University of Economics and Business, '*2005 Corporate Governance Survey*' (2005), at 16; and Grant Thornton and Athens University of Economics and Business, '*2006 Corporate Governance Survey*' (in Greek) (2006), at 16.

corporate governance requirement,[526] revealing once more that Greek corporations are not informed by international best practices. In addition, such state of affairs raises concerns about the effectiveness of the Board, the overall governance efficiency, the extent to which the independence at the highest level of corporations is ensured, and whether potential conflict of interests are avoided.

Importantly, such a phenomenon is not met in the UK FTSE 100 corporations, where only 11% of the companies share their chairman with another corporation.[527] This reveals a strong compliance with the principle of the revised Combined Code, which states that 'no individual should be appointed to a second chairmanship of a FTSE 100 company'.[528]

Finally, the establishment of a nomination committee and the development of specific procedures for appointing new members of the Board of Directors is recognised by international corporate governance practices as important for good governance.[529] Still, the statistics for the compliance levels of Greek corporations with this principle are not good. This is so given that in

[526] There is only a very narrow obligation introduced by the Corporate Governance Law of 2002, which is limited to govern the disclosure of conflicts of interest, which may arise from the exercise of their tasks. *See, e.g.,* Hellenic Law 3016/2002 *on Corporate Governance, Board Remuneration and Other Issues,* Official Government Gazette 110/ 17.05.2002 as amended by Law 3091/2002, (Official Government Gazette A330/ 24.12.2002), Article 2, paragraph 3. [Hereinafter the Corporate Governance Law of 2002].

[527] *See, e.g.,* Grant Thornton (UK), Risk Management Services, *'Third FTSE 350 Corporate Governance Review: Highlighting Trends in Compliance'* (2004), at 13; Grant Thornton (UK), Risk Management Services, *'Fourth FTSE 350 Corporate Governance Review: Highlighting Trends in Compliance'* (2005), at 12; and Grant Thornton (UK), Risk Management Services, *'Fifth FTSE 350 Corporate Governance Review 2006: Highlighting Trends in Compliance'* (2006), at 14.

[528] *See, e.g.,* Financial Reporting Council – (FRC), *'The Combined Code on Corporate Governance'* (2006) June, at A. 4.3.

[529] *Id.* at A 4.1.

2005 16.2% (20.6% in 2006) of the Greek corporations enquired disclosed their procedures for appointing new members of the Board of Directors.[530]

This statistics can mean four things. First, that since the majority of Greek corporations do not publish their nomination policy, it can be assumed that perhaps they do not have one in the first place. Second, the above assumption on the absence of nomination policy can be further supported by the family origins of Greek corporations, the operations of which have not demanded the adoption of such policy. Third, adjacent to the family origin of Greek corporations rests also the fact that the general practice of Greek corporations to base their decision on appointing new members of the Board on abstract and personal criteria (such as recommendation from close relatives, or people with close ties) makes it hard for corporations to comply with independent and subjective nomination criteria. Fourth, that Greek corporations seem to lack a corporate governance driven corporate culture that would underline the importance of complying with requirements even if there are not compulsory. Against this backdrop, it is important that Greek corporations make all necessary efforts to capture the essence of efficient governance, such as to be informed by international best practices.

Independent Non Executive Members

In addition to the moderate levels of independence of the highest ranking officers of corporations, as analysed above, the appointment of independent non executive directors is a decisive factor on the overall governance performance. As discussed in previous chapters, independent

[530] *See, e.g.*, Grant Thornton and the Athens University of Economics and Business, *'2005 Corporate Governance Survey'* (2005), at 20.

directors as a disciplining mechanism to alleviate the agency problems is recommended by various corporate governance codes,[531] in order to minimise any complications from the combination of the roles of CEO / Chairman and more significantly, for the protection of the interests of shareholders, and particularly the minority shareholders.

When it comes to discussing the important role of independent directors within the specific shareholding structure of family owned businesses, the following considerations come to the fore. First, the presence of independent directors in the family boardroom is important, in order to safeguard sound decisions and family control over management. Second, independent directors have a special value for family firms, as an effective mechanism to mitigate family opportunism.[532] Third, independent directors are in better position for tackling specific problems or issues and especially in the field of strategy, if they ask the right questions.[533]

Against this background, the essence of Article 3 of the Corporate Governance Law of 2002 is based on the separation of executive and non executive Board members. Additionally, the legal manifestation of the *'protection of the general interest of the company'*, as the primary

[531] For instance, the Cadbury Report recommended that there should be a strong independent element to the board to prevent chief executives from becoming too powerful. *See, e.g.*, Committee on the Financial Aspects of Corporate Governance (The Cadbury Committee), '*Financial Aspects of Corporate Governance*' (1992) December (the Cadbury Report), Principle 4.9. This stance was reiterated later in the text of the Combined Code. The Combined Code provides that all the members of the board committee that determines the remuneration of the executive directors should be independent non-executive directors. In addition, at least three non-executive directors must sit on the company's audit committee and they must form the majority on that committee. *See, e.g.*, Committee on Corporate Governance, '*Principles of Good Corporate Governance and Code of Best Practice*' (1998) June (the Combined Code).

[532] *See, e.g.*, Mavrides, M., and M. Olympios, 'Governance Issues in Family-Owned Public Companies and Consequences on Shareholder Value' (2004) Cyprus College School of Business, Laboratory for Business, Ethics and Society (LaBES), Working Paper, at 8 and 37; and Cadbury Sir, A., 'Family Firms and their Governance: Creating tomorrow's Company from Today's' (2000) Egon Zehnder International, at 28.

[533] *See, e.g.*, Cadbury Sir, A., 'Family Firms and their Governance: Creating tomorrow's Company from Today's' (2000) Egon Zehnder International, at 28-30.

responsibility of the Board of Directors, is referred to in Article 4 of the Corporate Governance Law of 2002, which introduces the concept of independent non executive Board members.[534]

According to those provisions, *'the Board of Directors consists of executive[535] and non-executive[536] members [...], the number of non-executive Board members should not be lower than one third (1/3) of the total number of Board members [...], at least two of the non-executive members must be independent'.*

More particularly, according to the findings of the 2005 Corporate Governance Survey, almost all companies seem to meet the legal requirements of the Corporate Governance Law of 2002 regarding the adequate number of non executive and independent non executive members that sit in the Board of Directors. In 98.1% of the companies, non executive directors represent at least 1/3 of the total number of Board of Directors members. Accordingly, at least two independent non executive members sit in 97% of the companies.[537] Such good statistics with regard to non executive members are also documented in 2006.[538]

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[534] This is also reflected in Principle 5.6 of the Mertzanis Report. *See, e.g.,* Committee on Corporate Governance in Greece (under the coordination of the HCMC) 'Principles on Corporate Governance in Greece: Recommendations for its Competitive Transformation' (The Mertzanis Report) 1999 Athens, Greece.

[535] The Board members dealing with daily administrative issues of the corporation are considered to be the executive members. *See, e.g.,* Hellenic Law 3016/2002 *on Corporate Governance, Board Remuneration and Other Issues*, Official Government Gazette 110/ 17.05.2002 as amended by Law 3091/2002, (Official Government Gazette A330/ 24.12.2002), Article 3, paragraph 1.

[536] Non-executive are the Board members mandated with the promotion of all corporate issues. *See, e.g.,* Hellenic Law 3016/2002 *on Corporate Governance, Board Remuneration and Other Issues*, Official Government Gazette 110/ 17.05.2002 as amended by Law 3091/2002, (Official Government Gazette A330/ 24.12.2002), Article 3, paragraph 1.

[537] *See, e.g.,* Grant Thornton and the Athens University of Economics and Business, *'2005 Corporate Governance Survey'* (2005), at 20-21.

[538] 76.4% of the companies comply with the requirements with regard to the appointment of non executive members, and 95.5% with the requirement on independent non executive

Beyond the high levels of compliance with the above corporate governance requirements, there seems to be a discrepancy between meeting the requirements of appointing independent non executive directors and ensuring in practice the independence of those directors. Notably, the majority of the companies inquired for the purposes of the 2005 Corporate Governance Survey, claimed to sufficiently ensure the independence of their board members.[539] In practice, however, it appears that only 6 out of 10 companies truly ensure their independence.[540] This statistic is improved in 2006, without yet adequate signs of elimination of the above mentioned discrepancy.[541]

As described in the previous chapter, the reasons for such discrepancy mainly rest on the poorly drafting of the Corporate Governance Law of 2002, which has determined the concept of independent non executive directors upon the use of qualitative criteria. Such criteria are based on the lack of directors' dependence with the company, namely the absence of conflict of interest.[542] Additionally, another important reason relates to the fact that the Law does not provide a definition of who is regarded as being independent or what constitutes independence. Rather, the Law defines what constitutes a relation of dependence. Due to such definition gap, interpretational problems have arisen and Greek corporations have not received more specific guidance in that regard excusing to some certain extent their difficulty in ensuring directors' independence. All the above factors considerably limit the range of

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members. *See, e.g.*, Grant Thornton and Athens University of Economics and Business, '*2006 Corporate Governance Survey*' (in Greek) (2006), at 20-21.

[539] *See, e.g.*, Grant Thornton and the Athens University of Economics and Business, '*2005 Corporate Governance Survey*' (2005), at 22.

[540] *Id.* at 23.

[541] *See, e.g.*, Grant Thornton and Athens University of Economics and Business, '*2006 Corporate Governance Survey*' (in Greek) (2006), at 23.

[542] *See, e.g.*, Mouzoulas, S., *Corporate Governance: International Experience, Greek Reality* (in Greek) (Sakkoulas Publications, Athens 2003), at 327-328.

potentials of the provisions on non executive and independent non executive members.

Finally, although the appointment of independent non executive directors is the centrepiece for the protection of the general interest of the company, the application of the following exception creates concerns on its correctness. Article 3, paragraph 1 of the Corporate Governance Law of 2002 stipulates that '*in case where representatives of the minor shareholders are explicitly appointed in the Board and participate therein as members, the participation of independent members is not obligatory*'.

Beyond the debate on the appropriateness of this exception and the extent to which and it undermines the significance of the appointment of independent non executive members in the Board of Directors, the findings of the 2005 Corporate Governance Survey are revealing. The survey shows that only a small proportion of companies (24%) have a Board member that is representing the minority shareholders.[543] This finding is important, since it reveals that the interests of the minority shareholders in the Greek corporate market are not effectively protected. The latter is in conformity with the findings of La Porta et. al,[544] who showed that civil law countries give shareholders the weakest protection.

To sum up, the above findings, which are closely associated with the ones relating to the independence at the highest levels of Greek corporations, support the main proposition of the thesis. Greek corporate governance, although in recent years it has shown signs of remarkable improvement, still

[543] *See, e.g.,* Grant Thornton and the Athens University of Economics and Business, *'2005 Corporate Governance Survey'* (2005), at 24.
[544] *See, e.g.,* La Porta, R., F. Lopez-de-Silanes, and A. Shleifer, and R. Vishny, 'Law and Finance' (1998) 106 J Pol Econ 1113, 1127-1133.

falls short compared to the efficiency of other governance systems. Hence, it seems more prudent to admit the fact that the Greek corporate governance is getting better, yet more effort is still needed so as to ensure that a truly efficient and strong system is in place.

Remuneration Policy for Board Members

The Board of Directors assumes full responsibility to set and implement the general remuneration policy of the company and is prohibited from transferring this right to third parties. As this is stipulated by Article 3, paragraph 2, of the Corporate Governance Law of 2002, high levels of compliance are expected, an expectation that is to a large extent confirmed since of the total companies enquired in 2005 and in 2006, 97% and 90.5% of them, respectively, claim that their Board of Directors determines the remuneration policy.[545]

However, when it comes to the number of companies that have established a Remuneration Committee, statistics are significantly lower (in 2005, 15.5% of companies and in 2006, 29.2% of companies comply with such soft law requirement).[546] Such low compliance on that issue reflects two country-specific issues. One, it is the practice of Greek corporations not to comply -to a large extent- with best practices and recommendations. Despite the Mertzanis Report recommendation that '*it is a good practice that a review committee is established, which would review management compensation*'

[545] *See, e.g.*, Grant Thornton and the Athens University of Economics and Business, '*2005 Corporate Governance Survey*' (2005), at 25; and Grant Thornton and Athens University of Economics and Business, '*2006 Corporate Governance Survey*' (in Greek) (2006), at 25.
[546] *See, e.g.*, Grant Thornton and the Athens University of Economics and Business, '*2005 Corporate Governance Survey*' (2005), at 26; and Grant Thornton and Athens University of Economics and Business, '*2006 Corporate Governance Survey*' (in Greek) (2006), at 26.

still only a small minority of Greek companies has set up a Remuneration Committee empowered to review management compensation.[547] Two, it is the small size of Greek corporations due to which the latter decide in practice to set aside time at Board meetings to specifically address matters that would ordinarily fall to a remuneration committee. In this setup, the small size of Greek corporations may render the option of a separate remuneration committee as expensive.

Furthermore, a paradox is documented with regard to the factors that determine management compensation. The Mertzanis Report recommends that management compensation shall be tied to corporation's general level of profitability and overall performance.[548] Notwithstanding that partial compliance is expected with such soft law principle, on the contrary the majority of the companies relate management compensation with performance elements (e.g. achievement of company's goals, firm performance, and firm profitability).[549]

On the other side, Greek companies are not in the right direction with regard to requirements on the transparency and disclosure of total compensation of management. In 2006, whereas improved statistics are recorded compared to the previous year, almost six out of ten companies

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547 *See, e.g.,* Grant Thornton and the Athens University of Economics and Business, '*2005 Corporate Governance Survey*' (2005), at 26; and Grant Thornton and Athens University of Economics and Business, '*2006 Corporate Governance Survey*' (in Greek) (2006), at 26.

548 '*It is a good practice that management compensation be tied to corporation's general level of profitability and overall performance. It is a good practice that the total compensation of management be disclosed and justified in the financial statements of the corporation. It is a good practice that concrete determination procedures be adopted for management compensation.*' *See, e.g.,* Committee on Corporate Governance in Greece (under the coordination of the HCMC) 'Principles on Corporate Governance in Greece: Recommendations for its Competitive Transformation' (The Mertzanis Report) 1999 Athens, Greece, at 16 (§ 7.1).

549 *See, e.g.,* Grant Thornton and the Athens University of Economics and Business, '*2005 Corporate Governance Survey*' (2005), at 27; and Grant Thornton and Athens University of Economics and Business, '*2006 Corporate Governance Survey*' (in Greek) (2006), at 27.

(from five out of ten, in 2005)[550] report management compensation separately and with the required justification in the company's annual report.[551]

Internal Control and Risk Management Systems

Efficient governance should also take into account the development of appropriate internal control systems and the set up of an Internal Audit Committee, which would review the internal control systems. More particularly, internal control system is the set of all those mechanisms designed to provide reasonable assurances with regard to the achievement of corporate objectives. Effective internal control system is such system that can timely identify all those threats endangering the control environment and can develop adequate control procedures in order to minimize or eliminate those risks.[552]

According to the findings of both the 2005 and the 2006 Corporate Governance Survey, almost 3/4 of companies have established an Internal Audit Committee.[553] However, the surveys do not depict statistics on whether the board of directors of Greek corporations truly rely on the work of the audit committee to enhance its monitoring ability.[554] Rather an audit committee that

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[550] *See, e.g.,* Grant Thornton and the Athens University of Economics and Business, *'2005 Corporate Governance Survey'* (2005), at 30.
[551] *See, e.g.,* Grant Thornton and Athens University of Economics and Business, '*2006 Corporate Governance Survey*' (in Greek) (2006), at 30.
[552] *See, e.g.,* Bank of Greece Governor's Act 2577/2006 *on the Framework Principles for the Operation and Evaluation Criteria of Systems of Internal Controls of Credit Institutions and Financial Institutions and relevant responsibilities of their administrative bodies* (in Greek) Official Government Gazette A59/ 09.03.2006.
[553] *See, e.g.,* Grant Thornton and the Athens University of Economics and Business, *'2005 Corporate Governance Survey'* (2005), at 36; and Grant Thornton and Athens University of Economics and Business, '*2006 Corporate Governance Survey*' (in Greek) (2006), at 36.
[554] *See, e.g.,* Menon, K., and J. D. Williams, 'The Use of Audit Committees for Monitoring' (1994) 13 Journal of Accounting and Public Policy 121, 121.

intends to play a major role in oversight would need to maintain a high level of activity in that a sufficient number of meetings are held.

Beyond such strong compliance with this Mertzanis Recommendation,[555] nearly 3 out of 10 companies[556] satisfy the recommendation that the Internal Audit Committee should consist of at least 3 non executive members of the Board of Directors.[557] On the contrary, the overall figure relating to the independence of the audit committee of the British companies shows improvement (88.5% in 2006 from 86% in 2005)[558], which indicates further that the authority and influence of the audit committee continues to grow, in line with the provisions of the Combined Code.[559]

Furthermore, an efficient corporate governance framework should ensure the conditions for best corporate performance and long-term sustainability. For achieving this objective, it is important that the internal controls of a company evolve and are kept continuously under review in that to adapt to the changing nature of risks and ensure that all risks are properly and promptly identified.

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[555] *'The establishment of an Internal Audit Committee should be encouraged, which will consist of non executive members of the Board of Directors'. See, e.g.,* Committee on Corporate Governance in Greece (under the coordination of the HCMC) 'Principles on Corporate Governance in Greece: Recommendations for its Competitive Transformation' (The Mertzanis Report) 1999 Athens, Greece, at 12 (§ 4.7).

[556] *See, e.g.,* Grant Thornton and the Athens University of Economics and Business, *'2005 Corporate Governance Survey'* (2005), at 36; and Grant Thornton and Athens University of Economics and Business, '*2006 Corporate Governance Survey*' (in Greek) (2006), at 36.

[557] *See, e.g.,* Committee on Corporate Governance in Greece (under the coordination of the HCMC) 'Principles on Corporate Governance in Greece: Recommendations for its Competitive Transformation' (The Mertzanis Report) 1999 Athens, Greece.

[558] *See, e.g.,* Grant Thornton (UK), Risk Management Services, *'Fourth FTSE 350 Corporate Governance Review: Highlighting Trends in Compliance'* (2005), at 14; and Grant Thornton (UK), Risk Management Services, *'Fifth FTSE 350 Corporate Governance Review 2006: Highlighting Trends in Compliance'* (2006), at 16.

[559] According to Principle C.3.1., '*The board should establish an audit committee of at least three members, who should all be independent non executive directors*'. *See, e.g.,* Financial Reporting Council – (FRC), *'The Combined Code on Corporate Governance'* (2006) June, at C.3 'Audit Committee and Auditors'.

As risk identification is an important issue pertaining to the efficiency of the corporate governance framework, it is very encouraging that the vast majority of Greek corporations (81.3% in 2006 from 73.3% in 2005) have placed great attention to effective and up-to-date risk management structures so as to ensure stability and continuity in their businesses.[560] In a similar vein, UK public limited corporations show positive statistics in that 98.1% of them have recognized the Turnbull guidance in managing their risk.[561]

Finally, the analysis of the level of compliance with regard to issues of organisation and the set of internal regulations reveals with the most prominent way the tendency of Greek corporations to comply with the letter of the corporate governance rules but not with the spirit of them. In this setup, the vast majority (the statistic raised from 97.1% in 2005 to 98.5% in 2006) of Greek corporations are recorded to satisfy the legal requirement of the Corporate Governance Law of 2002 with regard to approving a set of internal regulations.[562]

It is very positive that a considerable improvement has been documented with regard to compliance on 'one-to-one' basis with the specified minimum contents of the set of internal regulations. More particularly, in 2005 only 28.7% of the companies complied, on a 'one-to-one' basis, with the minimum content of the Internal Regulation, as

[560] *See, e.g.*, Grant Thornton and the Athens University of Economics and Business, *'2005 Corporate Governance Survey'* (2005), at 38; and Grant Thornton and Athens University of Economics and Business, *'2006 Corporate Governance Survey'* (in Greek) (2006), at 38.
[561] *See, e.g.*, Grant Thornton (UK), Risk Management Services, *'Fifth FTSE 350 Corporate Governance Review 2006: Highlighting Trends in Compliance'* (2006), at 25; and Institute of Chartered Accountants in England and Wales - (ICAEW), *'Internal Control: Guidance for Directors on the Combined Code'* (1999) September (The Turnbull Report).
[562] *See, e.g.*, Grant Thornton and the Athens University of Economics and Business, *'2005 Corporate Governance Survey'* (2005), at 31; and Grant Thornton and Athens University of Economics and Business, *'2006 Corporate Governance Survey'* (in Greek) (2006), at 31.

determined by the Corporate Governance Law of 2002.[563] This last statistic, in 2006 has been increased to 51.5%.[564] This is very encouraging to the extent that Greek corporations make serious efforts to improve governance efficiency.

The reasons that can explain the strong compliance with regard to internal control and risk management practices can be summarised to be the following. First, the requirements on the establishment of adequate systems of internal control and risk management mechanisms are envisaged by existing ASE rules. These are key prerequisites for corporations that are in the process of being listed in the stock exchange, and stringent obligation for all listed companies to follow. Second, a large number of the listed corporations in the ASE are financial and credit institutions, which operate under a strict regulatory framework on the system of internal controls and risk management. Such framework has been imposed by the Bank of Greece Governor's Act 2577/2006.[565]

However, Greek corporations need to focus more effort in truly internalising the corporate governance requirements into their daily operations, and avoid dealing with corporate governance obligations merely as a checklist of requirements.

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563 *See, e.g.,* Grant Thornton and the Athens University of Economics and Business, '*2005 Corporate Governance Survey*' (2005), at 31.

564 *See, e.g.,* Grant Thornton and Athens University of Economics and Business, '*2006 Corporate Governance Survey*' (in Greek) (2006), at 31.

565 *See, e.g.,* Bank of Greece Governor's Act 2577/2006 *on the Framework Principles for the Operation and Evaluation Criteria of Systems of Internal Controls of Credit Institutions and Financial Institutions and relevant responsibilities of their administrative bodies* (in Greek) Official Government Gazette A59/ 09.03.2006.

Participation of Shareholders in the Governance Processes

Efficient governance should also take into account the rights and responsibilities of shareholders in that it should satisfy a wide range of requirements for disclosure of information to shareholders. Such requirements include, *inter alia,* the dissemination of information regarding the effects of economic and non economic events expected to affect the performance of the company. In a similar vein, the publication of financial statements and the protection of shareholders' rights to participate in the governance processes (e.g. in the case of Greek corporations, the General Shareholders' Meeting) are of significance for an efficient governance system.

For those reasons, the Mertzanis Report recommended that '*shareholders should have the right to participate equitably and efficiently in the General Shareholders' Meeting and be sufficiently, timely, and properly informed on the decisions that need to be made regarding fundamental changes in the corporation*'.[566] In that regard, there are strong and positive results documenting that the majority of Greek corporations (from 86.4% in 2005, to 93.9% in 2006) have recognised the importance of disclosing information to shareholders on all material matters.[567]

Specifically, the findings of the 2005 and 2006 Corporate Governance Survey reveal a paradox. High percentage of Greek companies that recognise the importance of facilitating the participation of shareholders in the

566 *See, e.g.,* Committee on Corporate Governance in Greece (under the coordination of the HCMC) 'Principles on Corporate Governance in Greece: Recommendations for its Competitive Transformation' (The Mertzanis Report) 1999 Athens, Greece, at 8 (§ 1.2).

567 *See, e.g.,* Grant Thornton and the Athens University of Economics and Business, '*2005 Corporate Governance Survey*' (2005), at 42; and Grant Thornton and Athens University of Economics and Business, '*2006 Corporate Governance Survey*' (in Greek) (2006), at 42.

governance processes[568] contrasts with the considerable low statistics on the range of actions that corporations indeed take to ensure shareholders' participation. In 2005, 98.1% of the enquired companies claimed that they endorse the participation of shareholders in the decision making process, whereas only 65.3% of them give shareholders the right to vote via representative.[569] A similar trend is noted in 2006.[570]

All in all, Greek corporations should focus their efforts more on providing shareholders with the right of voting via representatives, distance voting, or voting by using electronic means (email, fax, etc.), which will further enhance shareholders' participation in the corporation's decision-making mechanisms.[571] To that direction will help the implementation in the Greek legal order of the Shareholders Rights Directive.[572]

Concluding Remarks

From the above analysis, it is confirmed that although good compliance levels are demonstrated with specific corporate governance requirements, overall there remains a discrepancy between the objectives of the corporate governance rules, actual compliance, and governance efficiency.

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[568] *See, e.g.,* Grant Thornton and the Athens University of Economics and Business, *'2005 Corporate Governance Survey'* (2005), at 44; and Grant Thornton and Athens University of Economics and Business, *'2006 Corporate Governance Survey'* (in Greek) (2006), at 44.

[569] *See, e.g.,* Grant Thornton and the Athens University of Economics and Business, *'2005 Corporate Governance Survey'* (2005), at 45.

[570] From the companies enquired, all of them (100%) claimed to endorse shareholders' participation in the decision making process, yet only 63.6% of them facilitate the exercise of shareholders' voting rights. *See, e.g.,* Grant Thornton and Athens University of Economics and Business, *'2006 Corporate Governance Survey'* (in Greek) (2006), at 45.

[571] Significantly, the most recent amendments of the Corporations' Law serve to that direction. More in particular, one of the main provisions that have been amended is the right of shareholders to vote via representatives and the establishment of teleconference meetings. *See, e.g.,* —— 'The Lifting of the Law on Public Limited Companies' (in Greek) *Ethnos* (14 June 2006).

[572] *See, e.g.,* Council Directive (EC) 2007/36/EC of 11 July 2007 on the Exercise of Certain Rights of Shareholders in Listed Companies [2007] OJ L184/17.

In this vein, it is admitted that the lack of a true internalisation of corporate governance principles, which are not to be treated as a checklist of requirements, restricts the achievement of the aims of the corporate governance rules and best practice recommendations. This is so mainly because Greece is a country, which besides the considerable amount of corporate governance principles that are in place, the efficiency of its governance seems to be circumscribed due to a number of country-specific conditions.

In an attempt to link such country-specific conditions with those indicators that are to ensure governance efficiency (e.g. the independence at the highest level of corporations to be fostered; the Board effectiveness to be secured; appropriate risk management and internal control systems to be set up; and enhanced transparency to be achieved) the following conclusions are reached.

First, the family origins and the personal character of Greek corporations makes it difficult for them to ensure compliance with a wide range of independence requirements (such as for instance, the separation of roles between the CEO and the Chairman of the Board of Directors; the development of nomination policy for the appointment of new members of the Board; or the elimination of the degree by which the CEO is company's major shareholder).

Second, the small size of the Greek market makes the adoption of some best practices very difficult and costly (such as the application of the principle of 'comply or explain', the set up of separate remuneration committee, or the facilitation of shareholders' participation in the decision making process using alternative means to exercise their voting rights). In addition, in the context of such a small market, the pool of high level executives is limited and shallow, explaining in turn the phenomenon of 'busy directors'.

Third, the limited external exposure of Greek corporations explains to some certain extent the low compliance with international prevailing corporate governance principles. A higher level of compliance with corporate governance principles is recorded, for instance, in corporations that have or are in the process of attracting foreign financing (e.g. listed in foreign stock exchanges). On the contrary, those corporations that are primarily operating within the boundaries of the Greek market show limited interest on good governance. This can be further explained on accounts of the fact that the domestic investors are not financially and corporate governance literate, since they have only seen investment in stock exchanges as a good opportunity for 'easy money'.

Fourth, the significant differences between the Greek and the UK statistics in certain independence and efficiency indicators reveal two important facts. First, that Greek corporations fail to be informed about other best practices (here the UK ones), which would offer a good example for governance efficiency. Second, the low compliance at corporations' level is documented in that the latter do not follow international best practices at their own initiative or based on their own interest for good governance.

Fifth, beyond the recorded high levels of compliance with the requirements on the representation of non executive and independent non executive members in the Board of Directors, there seems to be a discrepancy between meeting those requirements and ensuring in practice the independence of those directors. This is so mainly due to the poorly drafting of the Corporate Governance Law of 2002. This Law has determined the concept of independent non executive directors upon the use of qualitative criteria and has not provided a definition of independence. Such definition gap creates interpretational problems and limits the range of potentials of this provision.

Sixth, the effects of securities legislation (e.g. ASE Rules) are so pervasive that related requirements (such as for instance with regard to the development of adequate internal controls systems and effective risk management processes) are associated with strong compliance. This in turn reveals the restricted effects of the Corporate Governance Law of 2002.

Overall, a steady increase year-on-year is recorded, which suggests that Greek companies are demonstrating greater acknowledgment of the consideration of governance efficiency. Beyond such signs of progress, Greek corporations still fall short of certain corporate governance rules. Hence, it is important that the above findings are taken into serious consideration by those charged to truly embrace the spirit of good governance and are empowered to internalise corporate governance requirements so that governance efficiency is ensured.

3. COUNTRY-SPECIFIC FACTORS DETERMINING GOVERNANCE EFFICIENCY

Introduction

Notwithstanding that the issue of corporate governance has climbed up the agenda of listed companies, the public authorities, and other stakeholders in the Greek market, yet most companies tend to 'comply with the letter of the law without fully capturing the essence of efficient governance'.[573]

Notably, the findings of the 2005 and 2006 Corporate Governance Surveys reveal the Greek situation, where moderate levels of compliance are recorded not only with the non binding recommendations but also with the binding rules.[574] This is particularly interesting on five counts.

First, in that it confounds one's initial expectation that binding rules would be coupled with total compliance. Second, in that it confirms the fact that the specific structures of Greek corporations have set corporate governance obligations as exogenous ones. Third, in that internal corporate structures and penalty systems play a significant role in how corporations address corporate governance compliance internally or react to external enforcement stimulus. Fourth, in that it explains Greek companies' early rejection and conservatism against corporate governance rules that are perceived as 'another layer of regulation'. Fifth, in that it demonstrates the low levels of awareness of Greek companies for the benefits of good corporate governance.

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[573] *See, e.g.,* Grant Thornton and the Athens University of Economics and Business, '*2005 Corporate Governance Survey*' (2005), at 3.
[574] *Id.* at 3 - 5.

Additionally, such a situation seems to have become a status quo that is preserved due to the lack of enforcement actions and weak supervision. This is confirmed by measuring the total number of non-compliant corporations, as recorded by the surveys, with the total number of fines imposed by the competent supervisory bodies. Alongside the recorded discrepancy between the total number of non-compliant companies and the fines imposed against those non-compliant behaviours, supervisory gaps and lack of enforcement actions are fundamentally implied.

All the above considerations support the main claim at the core of this study that the objectives of the Greek corporate governance regime are not fully achieved due to a number of context-dependent variables. Therefore, the real benefits and positive efficiencies from the existence of a good corporate governance framework, as envisaged by the Greek corporate governance universe, seem not to be reaped.

The focus of the analysis now shifts to further identify those country-specific factors (such as the weak supervisory regime, lack of enforcement actions, the overly bureaucratic corporate governance framework, etc.) that have not only contributed to the aforementioned discrepancy but they have also affected the overall governance efficiency. Finally, this part concludes with an examination of the level and the key determinants of the corporate governance compliance behaviour within firms, which helps in generating more effective enforcement policies and regulations.

The Legal System

An efficient legal system not only facilitates the setting of the corporate governance standards but also ensures their proper implementation. In essence, the country's legal environment can influence the articulation and protection of shareholders' rights and the norms of transparency and disclosure. Whereas efficient legal frameworks are not a guarantee for strong corporate governance standards, yet, to a certain extent, a robust legal framework is a positive indication for efficient and strong governance.[575]

On the premises of the main conclusion of La Porta et. al.[576] that legal rules differ greatly and systematically across countries depending on the legal origin, a discussion on the legal family origin as an important determinant for governance efficiency is undertaken. Specifically, it is argued that the legal family origin shapes to a certain extent the degrees of procedural formalism and complexity, which both are key determinants for enforcing the law. For instance, England developed a common law tradition characterised by independent judges and juries. In this tradition, comparatively low importance is paid to regulation, whereas private litigation is preferred as a means of addressing social problems. By contrast, civil law traditions, including the Greek legal system, are characterised by state-employed judges, a preference for state regulation over private litigation and emphasis on legal and procedural codes.[577] Therefore, it is admitted that civil law countries tend to show a comparatively high degree of complexity and procedural formalism, in

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[575] *See, e.g.,* Cornelius, P., 'Corporate Practices and National Governance Systems: What Do Country Rankings Tell Us?' Deutsche Bank, Research Notes No. 16 (19 November 2004).

[576] *See, e.g.,* La Porta, R., F. Lopez-de-Silanes, and A. Shleifer, and R. Vishny, 'Legal Determinants of External Finance' (1997) NBER Working Paper 5879, at 3.

[577] *See, e.g.,* Cornelius, P., 'Corporate Practices and National Governance Systems: What Do Country Rankings Tell Us?' Deutsche Bank, Research Notes No. 16 (19 November 2004), at 5.

contrast with common law countries that tend to have less complex procedures.[578]

Against this background, it is important to note that in the particular situation of Greece, the legal family origin, in civil law, is of great gravity. Beyond the inherent rigidity of the civil law system, the overly bureaucratic legal framework that features the Greek market further limits governance efficiency.

Characteristics of the Greek Corporate Governance Universe

The analysis of the Greek corporate governance universe in the previous chapter has clearly established, *inter alia*, three important sets of facts that are relevant to take into consideration as efficiency parameters in the governance assessment exercise.

First, the Greek corporate governance universe has, *inter alia*, the following characteristics: (a) it entails a wide range of similar obligations and requirements, which are spread in several legal documents; (b) due to such regulatory overlapping, compliance confusion is created that further gives rise to weak regulatory compliance in that regard; (c) some corporate governance rules and principles create legal ambiguities, uncertainty and give rise to problems of interpretation; and (d) especially given the small size of the Greek capital market and the medium participation of foreign capital in the Greek market, it can be argued that an overly bureaucratic framework has been developed.

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[578] *See, e.g.*, Cornelius, P., 'Corporate Practices and National Governance Systems: What Do Country Rankings Tell Us?' Deutsche Bank, Research Notes No. 16 (19 November 2004), at 8.

Second, corporate governance matters are governed not only by numerous legal documents, as aforementioned, but most importantly by legal texts that move between the boundaries of capital market law and company law. This gives rise, *inter alia*, to supervisory problems in that no clear public body is responsible for monitoring the compliance with corporate governance obligations. Therefore, the existence of blurred supervisory roles results in poor monitoring of corporations' compliance with binding rules.

Third, as envisaged by the Corporate Governance Law of 2002, the Board of Directors stands at the apex of the Greek corporate governance system. This further explains why some other important corporate governance matters have been left unregulated (such as for instance the conflicts between shareholders and the management).

The above characteristics of the Greek market, added to the inherently rigid legal system, profoundly explain the reasons that the Greek governance is not as efficient as the aims of the corporate governance rules and principles have envisaged them to be. This is further manifested due to the recorded discrepancy between corporate governance rules and their implementation.

Quality of Law Enforcement and the Judicial System

In view of the aforementioned particularities of the Greek legal framework, it is documented that indeed more than half of the Greek public limited corporations comply with the binding corporate governance rules,[579]

[579] Totally, in Greece, three out of ten companies consider themselves to be fully compliant with the corporate governance requirements, (e.g. 30.3% in 2006 from 32.7% in 2006). *See, e.g.*, Grant Thornton and the Athens University of Economics and Business, '*2005 Corporate Governance Survey*' (2005), at 6; and Grant Thornton and Athens University of Economics and Business, '*2006 Corporate Governance Survey*' (in Greek) (2006), at 6. For the sake of

while the remaining fall short of complying. In further discussing those country-specific variables affecting the overall governance efficiency of the Greek system, we were confronted with the following situation. Although one would expect full compliance with the stringent and binding corporate governance rules, as stipulated by the Corporate Governance Law of 2002, yet the findings of the recent Corporate Governance Surveys describe a rather moderate level of compliance.[580]

On explaining such situation, the following analysis relies on two strongly interrelated issues. First is the fact that in Greece there is a considerable amount of corporate governance rules, usually scattered in several different legal documents. Second, having good corporate governance rules alone is not enough. It is not only the laws, but also their proper enforcement that determines the overall efficiency of the legal system.

Given that the first issue referring to the overly bureaucratic framework that prevails in the Greek market has been the subject of extended discussion of the previous chapter, the focus here rests on examining the conditions of law enforcement. In other words, the main issue concerns the conditions of law enforcement as key determinants on explaining why not all Greek companies comply with the binding corporate governance rules.

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comparison, strong compliance of UK corporations is recorded with regard to corporate governance requirements. Although, the statistics show a decline of the number of companies that consider themselves to be fully compliant (34.1% in 2006 from 57.8% in 2004), this deterioration shows that UK companies appear to be taking time to adapt to the revisions made to the Combined Code in 2003. *See, e.g.,* Grant Thornton (UK), Risk Management Services, *'Third FTSE 350 Corporate Governance Review: Highlighting Trends in Compliance'* (2004), at 6; and Grant Thornton (UK), Risk Management Services, *'Fifth FTSE 350 Corporate Governance Review 2006: Highlighting Trends in Compliance'* (2006), at 8.

[580] *See, e.g.,* Grant Thornton and the Athens University of Economics and Business, *'2005 Corporate Governance Survey'* (2005), at 6; and Grant Thornton and Athens University of Economics and Business, *'2006 Corporate Governance Survey'* (in Greek) (2006), at 6.

More particularly, in the debate of governance efficiency, empirical evidence shows, for instance, that it is not the presence of insider trading laws but rather actions taking against insider trading that help explain the development of securities markets.[581] In this vein, it is important to clarify that it is not the intention of the writer to admit that laws are not important but rather to support Lopez-de-Silanes conclusion that '*the development of capital markets depends crucially on laws that facilitate enforcement and the improvement of court procedures that allow for a more efficient dispute resolution*'.[582]

Therefore, effective enforcement is recognized as a key determinant for governance efficiency to the extent that enforcement actions aim to restrict rules from being broken. In the more specific context of the Greek enforcement regime, the level of enforcement of Greek corporate governance rules ranges between moderate to low. One possible explanation for such state of affairs might be the absence of strong institutional shareholders that can take legal action against Greek companies for wrongdoings, as is the case in the US. On the contrary, in Greece, enforcement actions are the solely responsibility of regulatory and supervisory authorities.

Second, the effectiveness of the enforcement regime is also determined upon the efficiency of the competent body empowered to monitor any breaches of existing regulations and impose sanctions or administrative

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[581] *See, e.g.*, Bhattacharya, U., and H. Dauk, 'The World Price of Insider Trading' (2002) 57 (1) J Fin 75, 76 [The authors in their paper test whether the presence and enforcement of insider trading laws by a country decreases its costs of capital. After collecting information on all countries that have stock markets, 103 in 1998, they find that 87 have laws banning insider trading but only 38 of them have ever enforced them. All their models find that the cost of capital is unaffected by the presence of insider trading laws, but is strongly affected by the enforcement of these].

[582] *See, e.g.*, Lopez-de-Silanes, F., 'A Survey of Securities Laws and Enforcement' (2004) Wld Bank Pol Res Working Paper 3405, at 28.

fines in that regard. More particularly, pursuant to article 10 of the Corporate Governance Law of 2002,[583] the Hellenic Capital Market Commission (HCMC) assumes its enforcement and investigative powers, as the main supervisory body in the securities markets. Given that the HCMC is the sole enforcer of corporate governance rules, then the total enforcement actions initiated by the HCMC will determine the overall efficiency of enforcement.

For the purposes of demonstrating the effectiveness of enforcement of the Greek regime, the statistics of the 2006 Corporate Governance Survey are used.[584] Specifically, the effectiveness of enforcement is measured by calculating the ratio of the total number of companies that were in breach of corporate governance rules, according to the survey's statistics, and the total fines imposed by the HCMC for breaches of corporate governance requirements.

According to available data, the HCMC, for the year 2006, imposed sanctions and administrative fines for breach of the obligation relating to non executive directors and independent non executive directors to six listed companies.[585] Notably, the statistics from the 2006 Corporate Governance Survey show that for the same period, twenty-one corporations were in breach

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[583] '*If the Hellenic Capital Market Commission detects that anyone performing Board responsibilities does not comply with the provisions of Articles three through eight (3-8) and eleven (11) of the present Law, it imposes administrative sanctions in accordance with §4b of Article 1 of Law No. 2836/ 2000, as amended*'. Hellenic Law 3016/2002 *on Corporate Governance, Board Remuneration and Other Issues*, Official Government Gazette 110/ 17.05.2002 as amended by Law 3091/2002, (Official Government Gazette A330/ 24.12.2002).

[584] *See, e.g.,* Grant Thornton and Athens University of Economics and Business, '*2006 Corporate Governance Survey*' (in Greek) (2006).

[585] *See, e.g.,* Hellenic Capital Market Commission, (Press Release), 'Board of Directors 396th Meeting of 31 August 2006' (in Greek) (31 August 2006).

of the same provisions.[586] Therefore, it appears that fifteen non compliant companies escaped being sanctioned by the HCMC.

Such enforcement situation, as pictured from the ratio of the fines imposed by the HCMC to corporations in breach of the Corporate Governance Law of 2002 (6 to 21 companies), demonstrate the following facts. First, the usual small size of Greek firms in association with the lack of effectiveness of the penalty system determines to some certain extent the compliance behaviour of Greek corporations. Corporations choose not to comply with corporate governance requirements if the compliance cost outweighs the penalty imposed to them in case that they are caught. Further, corporations' decision to be non compliant is validated by the limited possibility of being caught due to the inefficient enforcement system.

Second, the fines' scope is limited covering only breaches of corporate governance requirements relating to the appointment of non executive directors and independent non executive directors. This is paradoxical if one considers that the supervisory mandate of the HCMC relates to all the provisions of the Corporate Governance Law of 2002.

Third, due to lack of data on fines with regard to breaches of other provisions of the Corporate Governance Law of 2002, it can be assumed that in the past the HCMC has not investigated such breaches. This confirms the fact that the HCMC is in the process of structural and operational re-organisation in order to assume wider responsibilities on corporate governance matters.

[586] *See, e.g.* Grant Thornton and Athens University of Economics and Business, '*2006 Corporate Governance Survey*' (in Greek) (2006), at 6.

Fourth, the impetus for the debate over the narrow scope of the HCMC's supervisory responsibilities comes from the existing blurring of distinctions of corporate governance obligations that move around the boundaries of capital market and company law. Fifth, the number of companies that fail to comply with the corporate governance rules is considerable because the HCMC lacks the staff to enforce compliance with the Corporate Governance Law of 2002.

An important factor that further impedes the enforcement of the Corporate Governance Law of 2002 is the efficiency of the judicial system. In essence, an efficient enforcement regime will need some backing up from the judicial system.[587] In Greece, recourse to the court system is an extremely time-consuming process and most recently people have lost their trust on the judicial system primarily due to scandals with regard to complex hedge funds issued for national insurance funds. In addition, congestion of cases in Greek courts and slow pace of court proceedings usually take their share of blame in the problems associated with the law enforcement. This has in turn hampered speed and timely prosecution of cases.

Furthermore, the influence of corruption among Greek judges is evident in that cases of corruption among judges in Greece are not rare. Most recently, in 2005, a documented case of corruption involving a court justice occurred when a judge, for the period 2000-2004, released under no profound

[587] *See, e.g.*, Berglöf, E., and S. Claessens, 'Corporate Governance and Enforcement' in I. M. Millstein, S. G. N. Bajpai, E. Berglöf and S. Claessens (eds.), *Enforcement and Corporate Governance: Three Views* (Global Corporate Governance Forum, 2005) Focus 3, 27-63, at 46.

reasons drug dealers; modified the formation of the court in order to reach favourable decisions in return of some financial benefit from accused, etc.[588]

In practice, Greek judges can be said not to have earned a good reputation for integrity from the Greek society. The main reasons that can explain the phenomenon of corrupt judges in Greece can be the following. The first factor is the level of independence of the judiciary in Greece. Although it is firmly established by the Greek Constitution and through a number of laws; in reality constitutional and legal stipulations for the independence of judiciary powers are not rigorously observed. The second reason for corrupt judges in Greece relates to the level of transparency of the judicial procedures. Through trials are conducted in a public in that openness of trials is guaranteed, yet false and misleading evidence undermine the transparency of the process.

As explained above, the existence of cases of corruption among judges in Greece may also explain the level of enforcement and governance efficiency. Especially after the revelations of the recent cases of corruption among judges, the trust in Greek courts has been limited. This in turn has served as an obstacle for protecting shareholders' rights and ensuring successful business development.

Compliance at a Firm's Level

Companies play an integral role in the corporate governance wheel to the extent that they should ensure that corporate governance rules are

[588] *See, e.g.*, Kari, K., and P. Stathi, 'Shedding Light on the Corruption Machine' (in Greek) *Eleutherotypia* (16 June 2007); and —— 'Pleading Innocent: Mrs. Antonia Ilia for the Case of Corruption Among Judges' (in Greek) www.in.gr (04 February 2005).

understood not only as concept but most importantly as a practical tool of good management and shareholder value enhancement. Given that companies themselves can be partially responsible for the overall governance performance, rules and regulations shall be complemented by the adoption and promotion of good governance at a firm level, self regulation, self discipline, together with a commitment to the spirit of corporate governance principles.

It is important that attention to good corporate governance at the firm level is ensured in that any weaknesses in the legal framework to be partially compensated. Otherwise rules alone cannot prevent corporate wrongdoings or promote an efficient governance system. Further, the discussion that follows on the level of Greek firms' compliance with soft law on corporate governance matters has two main purposes. First is to examine the main drivers of firms' compliance behaviour. Second, examination of those influential factors helps the generation of more effective enforcement policies and regulations.

In terms of governance efficiency, there is a strong interrelationship between the level of compliance with the corporate governance principles and fully understanding their essence. Such relationship is revealed by the statistics of the Corporate Governance surveys, which show, *inter alia*, that among those companies that comply with the binding corporate governance rules, only a large minority of them complies with soft law international best practices[589] and the recommendations of the Mertzanis Report.[590]

[589] *See, e.g.*, Grant Thornton and the Athens University of Economics and Business, *'2005 Corporate Governance Survey'* (2005), at 14, 17-19, and 37.
[590] *Id.* at 8, 12, and 26.

Further, such patterns of compliance are most prominently documented by the following statistics. First, the recommendations of the Mertzanis Report suggest that corporations that do not comply with those recommendations can release a report of compliance.[591] Despite the existence of this option, only 18.8% of the enquired companies in 2006 (from 16.1% in 2005) are cognizant of the possibility to report on how they comply with corporate governance principles.[592] Second, similar low levels of compliance are recorded with regard to the recommendation on establishing a Remuneration Committee for determining directors' compensation. Only 29.2% in 2006 (from 15.5% in 2005) of companies have established a committee to review management compensation.[593]

Third, although international best practice considers the adoption of performance evaluation procedures crucial for good corporate governance,[594] still only four out of ten companies in 2006 (from two out of ten in 2005) have adopted the relevant practice.[595] Fourth, another indication of the level of 'lip service' paid by Greek corporations to international best practice relates to

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[591] *See, e.g.*, Committee on Corporate Governance in Greece (under the coordination of the HCMC) 'Principles on Corporate Governance in Greece: Recommendations for its Competitive Transformation' (The Mertzanis Report) 1999 Athens, Greece, at 7.

[592] *See, e.g.*, Grant Thornton and the Athens University of Economics and Business, *'2005 Corporate Governance Survey'* (2005), at 8; and Grant Thornton and Athens University of Economics and Business, *'2006 Corporate Governance Survey'* (in Greek) (2006), at 8.

[593] *See, e.g.*, Grant Thornton and the Athens University of Economics and Business, *'2005 Corporate Governance Survey'* (2005), at 26; and Grant Thornton and Athens University of Economics and Business, *'2006 Corporate Governance Survey'* (in Greek) (2006), at 26.

[594] According to the Principle A.6.1., *'The board should state in the annual report how performance evaluation of the board, its committees, and its individual directors has been conducted'*. *See, e.g.*, Financial Reporting Council – (FRC), *'The Combined Code on Corporate Governance'* (2006) June.

[595] *See, e.g.*, Grant Thornton and the Athens University of Economics and Business, *'2005 Corporate Governance Survey'* (2005), at 14; and Grant Thornton and Athens University of Economics and Business, *'2006 Corporate Governance Survey'* (in Greek) (2006), at 14. By contrast, the statistics show that there has been an overall reduction in the number of UK corporations, who gave no disclosure (only 10%) at all on performance evaluation and a greater number of companies (40% in 2006 from 31% in 2005) provided 'more' than minimal levels of explanation. *See, e.g.*, Grant Thornton (UK), Risk Management Services, *'Fifth FTSE 350 Corporate Governance Review 2006: Highlighting Trends in Compliance'* (2006), at 15.

transparency on how new Board members are appointed. Greek companies fall short of this international best practice, since the majority does not disclose their procedures on appointing new members of the Board.[596]

Such patterns of compliance with non binding corporate governance principles can be explained on the following grounds. First is the tendency of Greek companies to comply only with the letter of the law and not with the spirit of corporate governance rules. Second is the initial rejection of Greek companies of the introduction of corporate governance rules as 'another layer of regulation'.[597] Third is the low awareness of companies of the positive efficiencies of good corporate governance.

Last but not least, the firm size impacts on the compliance behaviour, in that small size of firms tend to inhibit compliance with corporate governance rules. This is mainly due to the allocation of limited resources within the firm to address corporate governance issues and to ensure awareness of corporate governance requirements. In view of such resource restrictions, smaller firms are less likely to implement a comprehensive corporate governance plan.

Notwithstanding that good corporate governance at the company level may compensate for weak framework conditions, still a strong legal framework is a necessary pre-condition for good governance. Ultimately, in order for a strong and credible corporate governance system to be developed, both the regulators and the market, specifically companies, must fully

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[596] *See, e.g.,* Grant Thornton and the Athens University of Economics and Business, *'2005 Corporate Governance Survey'* (2005), at 17; and Grant Thornton and Athens University of Economics and Business, *'2006 Corporate Governance Survey'* (in Greek) (2006), at 17.
[597] *See, e.g.,* Mouzoulas, S., *Law 3016/2002 on Corporate Governance: Article by Article Analysis - Evaluation from Institutional Investors' Perspective* (in Greek) (Sakkoulas Publications, Athens, 2003), at 6.

discharge their respective roles and responsibilities. Therefore, each party is an integral component of the corporate governance system and shall bear full responsibility in setting and implementing the corporate governance standards within their own environment.

PART THREE

RECOMMENDATIONS FOR IMPROVING GREEK CORPORATE GOVERNANCE

CHAPTER 5

SOME RECOMMENDATIONS FOR IMPROVING GREEK CORPORATE GOVERNANCE WEAKNESSES TOWARDS GREATER EFFICIENCY

1. INTRODUCTORY REMARKS

The Purposes and the Structure of this Chapter

This chapter seeks to discuss a wide range of proposals for improving the Greek corporate governance framework so that greater governance efficiency may be achieved. Good governance is essential for the successful long term development of Greece. Moving to good governance from its deeply rooted, country specific deficiencies, will inevitably be a long run, on going, perhaps never ending process in which both the substance and the sequencing of policies will be important. The shift from governance weaknesses to efficiency provides a special opportunity and challenge for policy makers and indeed for Greek society.

The key claim of this chapter is that the establishment of a strong, efficient, honest governance system is an ongoing priority for both firms and the Greek market, as a whole. It is admitted that the Greek corporate governance, already not bad but inefficient, can be further improved through mechanisms internal to the firm and external, as well.

More particularly, mechanisms internal to the firm are those procedures and initiatives that are undertaken at the firm level, e.g. by the management or the Board of Directors, in an attempt to ensure greater firm transparency and accountability. However, for such procedures to be initiated a key precondition is firms' awareness of the importance of introducing and applying good corporate governance practices. Therefore, the scope of the first recommendation covers mainly those steps in raising such awareness (such as the increased participation in international fora discussing corporate governance matters, the wider use of governance rating systems, etc.). Furthermore, the role of internal auditors and the audit committee in improving the governance process are also discussed as internal mechanisms in that procedures initiated by management include accountability reinforced and verified by credible auditing procedures.

External mechanisms are regarded those exogenous pressures to introduce and apply good corporate governance practices within the firm in order to legitimate and improve its governance efficiency. In this vein, recommendations on five dimensions are advanced. First, from a supervisory point of view the focus relies on strengthening the supervisory and monitoring capacity of the Hellenic Capital Market Commission (HCMC), as the competent body that is empowered to monitor and check compliance with corporate governance rules. Second, from a legal review perspective, codification and review of existing corporate governance rules is discussed in an attempt to eliminate the overly bureaucratic legal framework, obscurity, and inefficiency of those rules. Third, from a regulatory point of view, the increasing involvement of the ASE in the corporate governance regulatory process (listing requirements) is discussed. Fourth, from an enforcement perspective, the discussion focuses on the possible reforms mainly for the improvement of the judicial system so that enforcement and implementation of rules is enhanced. Fifth, on the shareholders' view, a discussion takes place on those measures that could ensure enhanced shareholders' rights and activism.

Further, within the framework to promote the positive efficiencies of good governance and enhance governance efficiency, the following recommendations are also discussed as a means to further advance the potential of the Greek corporate governance. First is the encouragement of the more active participation of business associations and unions. Second is the establishment of a Corporate Governance Association of Greece. Third is consideration of establishing a shareholders' association. Fourth, it is recommended that an Institute of Directors be established.

A corporate governance system must achieve a sensible balance among company managers' need for flexibility to meet rapidly changing business conditions, companies' need for low transaction cost access to capital markets, investors' need to monitor what managers do with their money, and small shareholders' need for protection against self-dealing practices and opportunism. The ultimate purpose is to develop a system that would ensure the accomplishment of the corporate governance objectives in that shareholders' rights are rigorously protected while the business development is ensured.

The following recommendations are intended to achieve that balance, against the specific background of Greece's current conditions. Essentially, the range of recommendations discussed goes beyond those that could merely help mitigate the country-specific obstacles, in that a greater corporate governance reform is imperative. Such reform aims at developing corporate governance structures and institutions that would allow Greek firms to become fully world class competitors, able to achieve world scale by partnering with companies from around the world.

2. SET OF RECOMMENDATIONS

Internal Mechanisms

Raising Firms' Awareness of the Strategic Benefits of Good Governance

As established in the previous analysis, the Greek compliance paradox rests on the state of affairs where moderate level of compliance is recorded not only with the non binding recommendations but also with the binding rules.[598] Such a state of affairs confirms the following propositions.

First, the specific corporate structures of Greek corporations have set corporate governance obligations as exogenous ones. Second, Greek companies' initial rejection of corporate governance rules is established. Third, there are the low levels of awareness of Greek companies for the benefits of good corporate governance. Last but not least, firm size impacts on the compliance behaviour in that small size of firms tend to inhibit compliance with corporate governance rules. This is mainly due to the allocation of limited resources within the firm to address corporate governance issues and to ensure awareness of corporate governance requirements. In view of such resource restrictions, smaller firms are less likely to implement a comprehensive corporate governance plan.

The above conditions are particularly important to be brought to the fore of the discussion given that companies themselves are to some certain

[598] *See, e.g.,* Grant Thornton and the Athens University of Economics and Business, '*2005 Corporate Governance Survey*' (2005), at 3 - 5.

extent responsible for the governance performance and for compensating any possible deficiencies of the current legal framework. In this sense, good corporate governance at the firm level shall be raised as a crucial element for companies' governance agenda and for corporate governance reforms.

Raising awareness of the strategic benefits of corporate governance, especially in family owned and non-listed companies is important for two reasons. First, companies need to realize that a well-functioning company has comparative advantages in a competitive business world. Second, that it is important that companies start considering corporate governance as a company investment leading to long term growth.

Important challenges that the Greek capital market faces are market transparency and instilling investor confidence. If the proper and profitable operation of the Greek securities and capital markets is to be achieved, it is important that Greek companies overcome their traditional mistrust of corporate governance principles. This can be achieved through proper information about the positive effects of good corporate governance. Essentially, Greek corporations should move away from a mere notional application of the provisions of the Corporate Governance Law of 2002 and seek their full internalization in the operations of their corporations, so as to reap the full range of benefits of good corporate governance.

Therefore, for further strengthening the Greek corporate governance framework, it is necessary that initiatives be taken in an attempt to sharpen the understanding of Greek corporations on the positive efficiencies of corporate governance. This can be done, *inter alia*, by corporations' active participation in international fora discussing corporate governance issues; by the encouragement of the participation of business unions and associations in the governance reform process; by the wider use of governance rating systems; and by educating future managers on the importance and role of good corporate governance.

Participation in International Corporate Governance Fora

Given that corporate governance is not just a box ticking exercise, corporations need an exchange of experience and cross pollination of ideas on corporate governance matters. For fully internalizing the essence of corporate governance requirements, it is important that corporations have access to practical guidance on efficiently implementing corporate governance mechanisms and institutions. To this end, their participation in international corporate governance fora should be encouraged.

More particularly, the importance of such fora rests on the fact that there participate business leaders from around the world and through discussions and roundtables priorities in corporate governance are identified. Such fora bring together business and government representatives, as well as international investors and companies, and have been proven successful in identifying practical ways to advance effective corporate governance programs. In addition, they give the opportunity to corporations to get together and talk together to find solutions on corporate governance matters that are better if they are not addressed by means of governmental regulation.[599] Good corporate governance shall allow concrete business-to-business dialogue on key corporate governance issues.[600]

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[599] *See, e.g.*, International Chamber of Commerce, *'Improving Corporate Governance Practices: Roundtable Report'* (2005) International Chamber of Commerce Roundtable on

In sum, international corporate governance fora are a valuable tool that can be used by corporations, business practitioners, or policy makers in better understanding the essence of corporate governance; to address challenges that may face; to provide concrete recommendations; and most importantly to learn from other companies through their corporate stories and to be informed about corporate governance developments worldwide.[601] The latter is particularly important for Greek corporations, since as documented in the Corporate Governance Surveys, they fall short of being informed on corporate governance practices of other countries.

Developing Corporate Governance Rating Systems

Complementary to the above, another effective means for raising companies' awareness on good corporate governance and for further promoting governance efficiency is the introduction of a governance rating methodology. The best governance framework does not guarantee acceptance and implementation if the companies themselves are not complying with the spirit of the corporate governance rules. The development of governance rating systems can provide a positive incentive structure for individual firm improvement.[602]

Corporate Governance, Istanbul (21 April 2005), speech by J. Sullivan, Executive Director of the Centre for International Private Enterprise (CIPE).

600 *See, e.g.,* International Chamber of Commerce, *'Improving Corporate Governance Practices: Roundtable Report'* (2005) International Chamber of Commerce Roundtable on Corporate Governance, Istanbul (21 April 2005), speech by J. L. Bravard, Electronic Data Systems Corporation (EDS) financial services leader.

601 *See, e.g.,* International Chamber of Commerce, *'Improving Corporate Governance Practices: Roundtable Report'* (2005) International Chamber of Commerce Roundtable on Corporate Governance, Istanbul (21 April 2005), at 29.

602 *See, e.g.,* Dallas, G., 'Country Influences on Individual Company Governance' in G. Dallas (ed.), *Governance and Risk* (New York, McGraw Hill, 2004), at 138-163.

Against this backdrop, a need is created to devise mechanisms and systems that would make companies do more than the minimum. One such practical tool has been recognised to be the development of governance rating systems that would facilitate companies to monitor the areas for governance reforms. Such self-assessment exercises, based on survey questionnaires that assess the governance performance via scorecard, opens the way to more systematic analysis and publication of the governance situation of a specific company. In turn, investors have an important tool in their hands in order to identify good corporate governance with a well-run and well-managed company.

More particularly, the benefits of such governance rating systems are, *inter alia*, that the work of analysts and investors through a systematic and easy overview of all relevant issues of good governance is significantly facilitated; companies are able to assess the quality of their governance situation and the level of compliance; the aggregate score of the participating companies will demonstrate strengths and weaknesses to be taken into account by regulatory authorities for policy making; there is an important objective measuring tool of the level at which companies' corporate governance compares with other companies' system; and finally, the credit ratings are a very useful management tool for chief financial officers and their superiors.[603]

For instance, in Germany, in order to encourage a wider understanding through the application of good governance in financial markets, a working

[603] *See, e.g.*, Drakos, P. G., (presentation in the Standard & Poor's event, Union of Listed Companies, Athens, 25 October 2005).

group of the 'German Society of Financial Analysts'[604] developed a 'Scorecard for German Corporate Governance' based on the Code of Best Practice.[605] Such scorecard model has found good reception also in other countries, including Russia and some Asian states.[606]

In Greece, an important initiative by the University of Athens, Department of Economic Sciences, took place relating to the development of a methodology on corporate governance rating. Such an initiative was undertaken for the first time in 2002 and was applied to family firms.[607] More particularly, its objectives are to provide an independent and reliable tool for all investors; to provide a comprehensive and specific rating regarding all corporate governance criteria for each company; to produce useful results of aggregated data for supervisory authorities; and to provide a basis for comparison.[608]

Notwithstanding the significance of the initiative of the Athens University to develop a corporate governance rating methodology to assess the corporate governance framework for Greek companies, still its restricted application only to family firms reflects an important limitation. Although such limited scope is well explained by the fact that family firms are an important and common form of business organization in Greece, yet, it is important that such rating methodology be applied to a broader group of listed

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604 Deutsche Vereinigung für Finanzanalyse und Asset Management' (DVFA). For more information, visit the official website http://www.dvfa.com/home/dok/35613.php.

605 *See, e.g.,* Berlin Initiative Group, 'German Code of Corporate Governance', June 2000, as last amended by Government Commission on the German Corporate Governance Code, 'Amendment to the German Code of Corporate Governance' (The Cromme Code) 25 October 2006.

606 *See, e.g.,* Bassen, A., D. Pupke, and C. Zöllner, 'Corporate Governance Rating auf Basis der DVFA-Scorecard' *Finanz Betrieb* No. 9 (2006) *(in German).*

607 *See, e.g.,* Spanos, L., L. Tsipouri, and M. Xanthakis, 'Corporate Governance Rating of Family Firms at the Athens Exchange Market' (2008) 34 (7) Managerial Finance *forthcoming.*

608 *Id.*

companies. In this context, the rating results and the aggregated scores for the Greek listed companies will more accurately represent the strengths and weaknesses of the corporate governance framework. This is so because it has be generally argued that family firms lack efficient corporate governance mechanisms and they demonstrate poor governance compared to non family firms.[609]

It is estimated that the use of such governance rating systems will be a key tool for institutional investors to consider when making investment decisions and reviewing existing portfolios. The need for in-depth corporate governance research and for general and specific comparative data on corporate governance practices in all major companies will be important especially due to the increasing role of institutional investors in the Greek market.[610]

Fostering Corporate Governance Education

Until recently, little emphasis has been given in management education to corporate governance matters and only a few schools taught corporate governance. However, in view of the recent corporate scandals and the increased need for greater governance efficiency, enhanced corporate governance education has assumed growing importance.

More particularly, it is argued that management degree programs should also offer a solid background in corporate governance. In this sense, topics, such as the role and responsibilities of the board of directors, the audit

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[609] *See, e.g.,* Spanos, L., L. Tsipouri, and M. Xanthakis, 'Corporate Governance Rating of Family Firms at the Athens Exchange Market' (2008) 34 (7) Managerial Finance *forthcoming.*
[610] *Id.*

committee and the importance of internal controls, shall be extensively discussed.

The importance of such targeted education is highly recognized to the extent that there is an increasing consensus on the fact that educating on corporate governance matters will help current or future business leaders to better detect corporate wrongdoings and deter corporate fraud in the future. In addition, corporate governance education will broaden risk management knowledge, as well, and enable managers to fully capture the essence of good corporate governance.

Promoting the Role of Auditors: Enhancing the Work of the Hellenic Institute of Internal Auditors (HIIA)

To continue with another avenue for boosting Greek corporate governance, the focus shifts to the role of internal auditors. Corporate governance requires strong internal mechanisms to ensure day to day compliance with legal requirements aiming to avoid loss or collapse. Therefore, it comes as no surprise that there is a general consensus on the importance of effective internal mechanism of governance.[611] The role of internal auditors is one important internal function that has acquired the position of possibly being the 'insider' that can act as a 'policeman' from

[611] *See, e.g.*, Singh, D., 'Corporate Governance and Banking Supervision' in D. Singh (ed.), *Banking Regulation of UK and US Financial Markets* (Ashgate Publishing, London 2007), at 96.

within.[612] Further, it is admitted that the work of the internal auditor complements the work of the supervisor and external auditor.[613]

The utility of the internal auditor forms part of the senior management arrangements and controls[614] and its importance is reflected from its four main roles. First, the role of supervision, prevention, and protection in that internal auditors supervise corporations in order to achieve compliance with existing laws and regulations. Further, their monitoring role captures also the objective to avoid significant faults so that integrity to be safeguarded.[615] Second, the role of promotion in that the internal audit function strengthens management, it advances the production of information technology, and the flow of information.[616] Third, the evaluation and certification of corporations' financial disclosures is the centrepiece of internal auditors' mandate. The verification of management's assertions about the effectiveness of companies' internal controls is vital in that it enables the organisation to utilise its own resources to correct its deficiencies, as and when they are identified.[617]

Fourth is the role of consultancy. This last function of internal auditors has been the subject of immense debate and regulatory reform in the US, especially after the Enron scandal. Although it exceeds the scope of this section to discuss the criticism advanced against such role, it is important to

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[612] *See, e.g.*, Morgan, G., 'Internal Audit Role Conflict: a Pluralist View' (1979) 5 (2) Managerial Finance 160.
[613] *See, e.g.*, Singh, D., 'Corporate Governance and Banking Supervision' in D. Singh (ed.), *Banking Regulation of UK and US Financial Markets* (Ashgate Publishing, London 2007), at 99.
[614] *Id.* at 97.
[615] *See, e.g.*, Karagiorgos, T., G. Drogalas, P. Christodoulou, and M. Pazarskis, 'Conceptual Framework, Development Trends and Future Prospects of Internal Audit: Theoretical Approach' (5th Annual Conference of the Hellenic Finance and Accounting Association, 15 – 16 December 2006, Thessaloniki, Greece), at 4.
[616] *Id.* at 5.
[617] *See, e.g.*, Singh, D., 'Corporate Governance and Banking Supervision' in D. Singh (ed.), *Banking Regulation of UK and US Financial Markets* (Ashgate Publishing, London 2007), at 97.

note that internal auditors are in a good position, more often than not, to provide management with accurate and sufficient information assisting them in decision-making.

For the effective performance of the abovementioned roles of internal auditors it is important that corporations themselves arrange that appropriate internal structures are in place. In this setup, the following arrangements are deemed important. First, internal auditors in order to be able to communicate their findings to those that can act upon their conclusions and recommendations within the organization, a gateway to the board of directors must be set up. In practice, the chief internal auditor shall have the power to report their findings to the appropriate levels of management. This is important to ensure that its findings and recommendations are given due attention and consideration and that they can be acted on.[618] Second, the organization must define the purpose and the authority of the internal audit by providing a charter for its role. This is mainly to give the internal audit the 'assurance' that its work is given a high degree of importance in the organization.[619]

In addition to the actions that must be taken from corporations themselves, a key recommendation on further improving the role of internal auditors rests on the increased involvement of the Hellenic Institute of Internal Auditors (HIIA). Particularly, its mission should be advanced so as to pursue two targets: first, promoting the role of internal auditors in the governance process; and second, ensuring that appropriate professional standards are met.

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[618] *See, e.g.*, Singh, D., 'Corporate Governance and Banking Supervision' in D. Singh (ed.), *Banking Regulation of UK and US Financial Markets* (Ashgate Publishing, London 2007), at 98.
[619] *Id.*

Therefore, the role of the HIIA shall be further enhanced given especially the fact that today the HIIA performs a very limited role in those areas. The objective will be to restructure the HIIA so that it is transformed into a body specializing on internal auditing. Its main mission shall be the support, promotion, and the training of audit professionals.

More particularly, through a range of open courses, technical guidance, seminars, networking opportunities, and tailored in-company training programs, the HIIA can help internal auditors in reaping their full potentials and in achieving professional excellence. Additionally, the role of the HIIA shall be also enhanced in the area of publications by issuing professional guidance to define, *inter alia*, the standards of the profession of internal auditing. Such publications shall aim to become the profession's quality benchmark and be adopted by organizations.

In addition, such enhanced role of the HIIA should be mainly dedicated to the following areas of interest. First, through the focused role of the HIIA on the profession of internal auditing, the importance of audit professionals to acquire business qualifications should be set as a minimum standard to carry out audit checks. Second, the HIIA should issue codes attempting to delineate a clear set of criteria to evaluate the services provided by an internal auditor. Such criteria should point out the importance of independence and objectivity in auditors' work, which is developed through ethical framework to govern its work.[620] Third, the HIIA should raise the

[620] For instance, according to the Code issued by the Institute of Internal Auditing – UK and Ireland, the internal auditor is required to comply with the following principles whilst undertaking its work. First, integrity in its decision-making. Second, objectivity in its assessment. Third, confidentiality of information. Fourth, competence to undertake the task. These principles are then fleshed out with further guidance to ensure the principles and standards are achieved. *See, e.g.*, Institute of Internal Auditing – UK and Ireland, *'Codes of Ethics and International Standards for the Professional Practice of Internal Auditing'* (2006).

awareness of Greek corporations on the importance for the internal audit function to be more risk focused.

Fourth, given that the size of corporations is a key determinant for the size of the audit function and the technical expertise in house,[621] the issue of outsourcing the audit functions becomes a relevant one. In this context, the role of the HIIA is significant mainly for three reasons. First, although for cost reasons, and the lack of expertise in certain cases, such as information technology, corporations decide to outsource audit functions, the HIIA, through its guidance, should make corporations aware of the risks and benefits of such option. Second, it should remind corporations of their responsibility to ensure that in cases that the audit function is outsourced it shall nevertheless be closely monitored. Third, similarly in case that outsourcing seems to be the only way, the HIIA should define the framework for such outsourcing, aiming to ensure that the main objectives and the functions of internal audit are appropriately performed.

Complementary to the above recommendations in promoting and developing professional practices of internal auditing, another key recommendation is discussed. It is recommended that a stricter approach be adopted with respect to non-qualified audit professionals, in that they should not be permitted to carry out audit checks. This can be achieved by enhancing the role of the audit function by accrediting to internal auditors a professional status. This is important in order to ensure that internal auditors have the required competence to undertake their tasks. In turn, their final reports that

[621] *See, e.g.*, Singh, D., 'Corporate Governance and Banking Supervision' in D. Singh (ed.), *Banking Regulation of UK and US Financial Markets* (Ashgate Publishing, London 2007), at 99.

include their main audit findings will enjoy greater recognition, in that they will have been the product of well-qualified and experienced professionals.

Such recommendation is particularly significant for the particular case of Greece, given that although there are certain professional qualifications that internal auditors need to acquire in order to perform audits, yet there are many cases where the number and professional quality of auditors are not fully suited to work requirements.[622] Therefore, it is highly recommended that non-qualified professionals shall not be permitted to carry out audit checks.

Such a recommendation serves to the fulfilment of the key corporate governance objectives and it further ensures higher levels of governance efficiency. First, it is to ensure the high quality of the internal audit function in that an appropriately resource internal audit function is in place, able to report to the audit committee and senior management. Second, it is to provide more accurate and reliable information to shareholders and investors in order to make informative decisions. Third, and most importantly, it is to safeguard the continuation of business activities, based on the timely identification from competent and experienced audit professionals of possible deficiencies.

Enhancing the Role of the Audit Committee

The previous analysis discussed a number of key recommendations in further promoting the role of internal auditors in an attempt to improve the Greek corporate governance framework in that greater governance efficiency is achieved. Building on this discussion, the enhancement of the role of the

[622] *See, e.g.*, Karagiorgos, T., G. Drogalas, P. Christodoulou, and M. Pazarskis, 'Conceptual Framework, Development Trends and Future Prospects of Internal Audit: Theoretical Approach' (5th Annual Conference of the Hellenic Finance and Accounting Association, 15 – 16 December 2006, Thessaloniki, Greece), at 5.

Internal Audit Committee in an attempt to achieve greater governance efficiency is also examined.

In principle, the audit committee acts on behalf of the board of directors to provide additional assurance and credibility to the corporation's financial report to shareholders.[623] In view of the role of overseeing the affairs of a company, the audit committee also assists in the review of the internal controls, internal-audit programmes, and the findings of audit assignments.[624] More importantly, the existence of audit committees reduces incidences of error, irregularity and of other accidents that produce unreliable financial reporting.[625]

The move towards an enhanced audit committee is by no means new nor is the focus, which refers to 'auditor independence', 'integrity', 'monitor', 'review', 'improvement'.[626] Notwithstanding that the literature on audit committees is rather vague when it comes to the effectiveness of them to avoid corporate failures[627] guidelines should be provided aiming to reinvigorate the audit committees potential to reduce the likelihood of corporate failure. Such guidelines must address the Greek-specific governance variations in an attempt to reduce the current excessive burden with high levels of details and voluminous reports.

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[623] *See, e.g.,* Singh, D., 'Corporate Governance and Banking Supervision' in D. Singh (ed.), *Banking Regulation of UK and US Financial Markets* (Ashgate Publishing, London 2007), at 100.

[624] *Id.*

[625] *See, e.g.,* McMullen, D. A., 'Audit Committee Performance: An Investigation of the Consequences Associated with Audit Committees', (1996) 15 (1) Auditing: A Journal of Practice and Theory 87.

[626] *See, e.g.,* Singh, D., 'Corporate Governance and Banking Supervision' in D. Singh (ed.), *Banking Regulation of UK and US Financial Markets* (Ashgate Publishing, London 2007), at 103.

[627] A reason that makes the research on the Audit Committee's actual effectiveness rests on the high degree of confidentiality that surrounds the meetings. *See, e.g.,* Spira, L., 'An Evolutionary Perspective on Audit Committee Effectiveness' (1998) 6 (1) *Corporate Governance: An International Review* 29; and Spira, L., 'Audit Committees: Begging the Question?' (2003) 11 (3) *Corporate Governance: An International Review* 180.

First and foremost, all Greek corporations shall be encouraged to form an audit committee as part of their senior management arrangements to ensure the effectiveness of their internal control systems. More importantly, the audit committee has been an established part of the governance of the majority of listed companies in Greece since 2002, yet there are some companies that fall short of complying.[628]

Second, it is important that Greek corporations rely extensively on the work of the audit committee. The mere formation of an audit committee does not necessarily mean that the board of directors relies on the work of the audit committee to enhance its monitoring ability.[629] Rather an audit committee that intends to play a major role in oversight would need to maintain a high level of activity in that a sufficient number of meetings are held.

However, the problem behind this consideration rests mainly on two aspects. First, that the board of directors is likely to be willing to incur the cost of an active committee, which meets frequently, only if they feel it is necessary to monitor management.[630] Second, the frequency of meetings of the audit committee as a measure of the committee's activity is associated with firm size and the presence of independent directors in the board.[631] Those issues can be thrown down as a challenge for Greek regulators and policy makers to address.

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[628] According to the Corporate Governance Survey, in 2005, 73.5% (75.4% in 2006) of the enquired companies had established an audit committee, as stipulated by Article 7 of the Corporate Governance Law of 2002 (*See, e.g.*, Hellenic Law 3016/2002 *on Corporate Governance, Board Remuneration and Other Issues*, Official Government Gazette 110/ 17.05.2002 as amended by Law 3091/2002, Official Government Gazette A330/ 24.12.2002). *See, e.g.*, Grant Thornton and Athens University of Economics and Business, '*2006 Corporate Governance Survey*' (in Greek) (2006), at 36; and Grant Thornton and Athens University of Economics and Business, '*2005 Corporate Governance Survey*', 2005, at 36.
[629] *See, e.g.*, Menon, K., and J. D. Williams, 'The Use of Audit Committees for Monitoring' (1994) 13 Journal of Accounting and Public Policy 121, 121.
[630] *Id.* at 124.
[631] *Id.* at 137.

Third, besides the fact that the Athens Stock Exchange (ASE) has endorsed the establishment of an audit committee as a listing requirement in 2002, the scope of the committee's activities is rather limited to determining whether directors discharge their statutory duty in the matter of financial statements. Therefore, it is suggested that a much wider role should be granted for the audit committee to focus on systems and controls and to assess a regulated firm's compliance with the regulatory regime. This will further enhance the role of the audit committee and will give it a new will to undertake its work with a greater degree of vigilance.

Fourth, for ensuring the effective operation of the audit committee it is imperative that the cooperation with the board of directors rests on a 'frank, open, and robust' manner with management pro-actively providing it with information it needs.[632] Therefore, it is recommended that the ASE should issue reports on further providing guidance to corporations on how to fully reap the full range of potentials from the proper operation of their audit committees.

Fifth, all listed corporations, under the auspices and the coordination of the ASE, should make sure that they provide all necessary support mechanisms (such as access to corporate information, IT systems, etc.) that will work as the foundation for audit committee to review and monitor the financial affairs of a company. Sixth, the audit committee needs to have in place a formal policy to carry out its review and assessment of audit work. Although such policy should be set within the spirit of corporations' strategic plans, it needs to be formulated in conjunction with the ethical guidelines

[632] *See, e.g.*, Financial Reporting Council – (FRC), '*Audit Committees: Combined Code Guidance*' (2003) January (The Smith Report).

published by the accountancy profession (e.g. the Hellenic Institute of Internal Auditors - HIIA).

Overall, while the general purpose of an audit committee may seem to be a panacea against incompetence and increased risk, an audit committee is only as effective as the reliance placed on it in an organisation.[633] Therefore, the focus of policy makers and regulators shall be directed towards raising corporations' awareness on the efficiencies and the vigilance of the work of audit committees.

External Mechanisms

Strengthening the Capacity of Supervisory Authorities

The central objective of the Hellenic Capital Market Commission (HCMC), as the main securities market regulatory and supervisory authority in Greece, is to promote transparent and efficient financial markets, and facilitate the adequate protection of investors. The HCMC is responsible for supervising the Greek securities markets and market participants, namely all listed companies, including but not limited to investment firms, mutual funds management firms, portfolio investment companies, the Athens Stock Exchange (ASE) (with both stock and derivative markets and a derivatives clearing house), and the Central Depository Company and Guarantee Fund.

It issues statutory rules and regulations aiming at investor protection; the safeguarding of capital market's normal operation; the improvement of market transparency; the enhancement of efficiency of the trading, clearing

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[633] *See, e.g.*, Singh, D., 'Corporate Governance and Banking Supervision' in D. Singh (ed.), *Banking Regulation of UK and US Financial Markets* (Ashgate Publishing, London 2007), at 102.

and settlement systems; and the efficient operation of capital market agencies and institutions. The HCMC not only sets standards that they must be met by regulated firms, but most importantly it can take action against firms if they fail to meet the required standards.

The HCMC has been given its statutory powers by the Law 3152/2003,[634] which transfers certain duties from the Athens Stock Exchange and the Ministry of Economy and Finance to the HCMC. By virtue of this Law, the scope of the HCMC's work has been increased to include the granting and revocation of licenses for the operation of securities markets and the issue of rules concerning the minimum capital required by market participants.

In terms of operational independence, the HCMC is subject to the supervision of the Ministry of Economy and Finance in that the President and the two vice-Presidents of the nine-seat Board are directly appointed by the Ministry. This means that the HCMC is not a sufficiently independent body, given the governmental influence on the appointment at the top of the board of directors.

Further, the HCMC is accountable to the Ministry of Economy and Finance and through them to the Greek Parliament. Under the Greek legislation, the HCMC must report on its achievements to the Parliament and the Ministry of Economy and Finance every year. In addition, the HCMC is

[634] *See, e.g.*, Hellenic Law 3152/2003 *on the Establishment and Supervision of the New Stock Exchange Market, New Responsibilities of the HCMC, Amendments to Stock Exchange Legislation and Other Provisions*, Official Government Gazette A152/ 19.06.2003, as last amended by Law 3371/2005 (Official Government Gazette A178/ 14.07.2005).

called, at least twice a year, to give evidence to a specialised Parliamentary Committee.[635]

The recorded lack of enforcement of legal rules and weak compliance of Greek corporations with corporate governance requirements, gives rise to a discussion of establishing an optimal framework where the regulatory responses and laws will be combined with adequate enforcement, incentives for stronger compliance and full internalization of rules and processes that will ensure the achievement of the objectives of the laws. Towards achieving such an objective, it is imperative that policy makers and supervisory bodies recognize that if good corporate governance is to work, corporations and other stakeholders must know that they are likely to be held accountable for wrongdoing and failure to comply with corporate governance rules. In other words, the issuance of corporate governance rules must be backed up with fines and sanctions to send a clear message to non compliant corporations.

In terms of restructuring and improving the HCMC, 1997 is considered as the benchmark year. This is when the Delta scandal occurred, revealing significant capital market supervisory, and monitoring deficiencies.[636] Following this scandal a wide range of reforms and modifications in the operation of the main supervisory body of the Greek capital markets were initiated. Beyond those pervasive reforms, the persistent

[635] *See, e.g.*, Hellenic Capital Market Commission, 'Annual Report 2006' (in Greek) (2007), at 13.

[636] The revelations for abuse of privilege information by several securities firms, but mainly DELTA Securities, with dramatic effects to the ASE performance, urged HCMC to conduct rigorous checks and controls on all securities firms, only to find out that all 65 securities firms operating in Greece in 1997 were found to operate with significant irregularities. The Delta scandal underlined the importance of adequate supervision to securities firms and this is a significant benchmark for the transformation of the HCMC. *See, e.g.*, Mandrou, I., 'The High Confidential Judgments' (in Greek) *TO VIMA* (23 March 1997) D02; and —— 'The HCMC Files a Lawsuit against DELTA Securities' (in Greek) *TO VIMA* (23 March 1997) D03.

weak law enforcement with regard to the corporate governance requirements, demands for further and more focused solutions.

First and foremost, it is important that enforcement regulators and supervisors are operationally and financially independent. In many countries, securities exchange regulators have their own sources of income, such as for instance the UK Financial Services Authority (FSA).[637] However, in case that the FSA has to transfer some parts of its sources of income to the general budget or otherwise have to get their budget approved by the Parliament or other governmental agencies, then their de facto independence is reduced.

If the HCMC is operationally and financially independent then it is more likely to resist political pressure. However, in the case of the HCMC, although it does not receive any funding from the Greek government, since its budget comes from fees charged to authorized firms, nonetheless, its budget must be approved by the Minister of Economy and Finance.[638]

Second, an effective supervisory body should be comprised of adequate, competent, and experienced staff. The HCMC should be considerably enlarged to include more supervisory experts and experienced on site inspectors, so as to fulfil its extended mandate of responsibilities. Such enlargement shall make sure that high quality people are attracted. Alongside the recruitment of experienced people, the HCMC shall consider establishing a graduate scheme. Through such scheme, the HCMC will be in position to hire highly promising graduates from prominent academic institutions and

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[637] The UK FSA is an independent non governmental body that does not receive any funding from the UK government. In order to finance its work, fees are charged to all authorised firms that carry out activities that the FSA regulates. More in particular, the FSA charges firms periodic fees (paid yearly); application fees; and special project fees. For more information, visit http://www.fsa.gov.uk/Pages/About/Who/Funded/index.shtml.

[638] *See, e.g.*, Hellenic Capital Market Commission, 'Annual Report 2006' (in Greek) (2007), at 13.

train them according to the set principles, objectives, and the mission of the organisation. Further, it is important that competitive remuneration and reward packages are offered to HCMC staff, mainly for two reasons. First, to attract the best qualified professionals, who more often than not come from the private sector where salaries are highly competitive. Second, to maintain low levels of turnover statistics. Finally, a targeted personnel development program should be developed in order to support staff in meeting high standards. Managers shall set clear objectives, motivate their staff, strengthen their sense of responsibility, and recognise their achievements.

Third, the HCMC should consider the creation of a specialised Corporate Governance Division. This will enable the HCMC to make more effective use of its expertise on corporate governance with more specialist resources. In a similar vein, heads of divisions and principal supervisors should receive appropriate training to improve their analysis and excel their perspective on corporate governance issues.

Fourth, the effectiveness of the HCMC depends on its degree of specificity. If HCMC's investigative powers are stronger and more dedicated to sanctioning misconducts, the behaviour of financial markets will be more disciplined. Similarly, greater enforcement actions against firms and individuals for breaches of regulation are important in order for the HCMC to send a clear message to the market about what standards must be met to achieve governance efficiency.

Fifth, the HCMC should define a clear plan upon which its range of activities will take place. This is an important ingredient so that greater efficiency in HCMC's operations to be achieved. There should be a consistent set of policy objectives and strategy.

Sixth, the HCMC in order to improve its effectiveness in preventing and detecting breaches with current rules shall make considerable investment in improving its technical infrastructure. More particularly, the development of automated monitoring systems will significantly enhance HCMC's capability to detect non compliance behaviours.

Seventh, it is recommended that the HCMC should proceed with a review of existing regulations to identify whether there is room for eliminating regulations in case that they seem to be unnecessary. Such review will facilitate greater regulatory efficiency on two accounts. First, specific rules might be identified that they need be replaced by principles. Second, the adoption of more risk based and proportionate policies might be possible.

Eighth, in further raising appropriate standards, alongside such review, the HCMC should pursue working more closely with industry to find solutions to corporate governance deficiencies. This can be accomplished, for instance, by the publication of discussion papers on corporate governance matters, seeking to receive comments from market participants. In turn, a proportionate level of consultation, prior to regulatory initiatives, with market participants should be established.

Overall, the focus of the HCMC should be directed towards becoming a transparent organisation with a wide range of rule making, investigatory, and enforcement powers in order to facilitate corporations and the market to promote governance efficiency. The HCMC should attach great importance to the continuous refinement and upgrade of its structures and processes. This will enable the HCMC effectively to respond to the rapidly evolving financial challenges.

Codification of Corporate Governance Rules

A characteristic of Greek corporate governance is that the relevant rules and requirements are dispersed in legal documents. This inconvenient state of things creates an overly bureaucratic framework and confusion to corporations as to their compliance obligations. A major development in the area of Greek corporate governance would be the codification of all substantive corporate governance rules in one easily accessible legal document. More specifically, codification should be viewed from its expansive form in that it would not only mean the task of collecting the existing rules and stating them concisely and clearly, but also to improving the substance of the rules (which in some cases that work would also involve some elements of law creating).[639] Such expansive approach is important to be adopted by codifiers in the case of Greece for three reasons. First is to choose between competing and overlapping corporate governance rules. Second is to fill up gaps on points on which the existing rules are uncertain, or altogether silent. Third, to give precision to abstract general principles.

To that end, a statutory committee should be established to oversee the preparation and the activities of such a project. As a first step in fulfilling its work, an Experts Group shall also be established to consider the possible approaches to codification and to advise on the scope and the extent of such

[639] *See, e.g.*, Brierly, J. L., 'The Codification of International Law' (1948) 47 Mich L R 2, 2.

approaches, particularly, in identifying any areas where the Group considers codification may give rise to policy or implementation difficulties.

The recommended codification of Greek corporate governance rules is a demanding, time-consuming, and resource intensive project. Similar important codification projects have successfully been completed in Greece. First is the codification of the Corporations' Law and the second is the Bankruptcy Law. The result of those codification projects has been to tidy up the law on those topics. The success of the codification process requires the extensive participation of legal experts with expertise, good knowledge of both capital market law and company law, and excellent drafting skills. An important part of this process are reckoned to be the role of the ASE, the HCMC, and other bodies (such as the FGI or the recommended Corporate Governance Association of Greece, etc.).

Among the benefits to be realised by such codification are the following. First is the ease with which corporate governance rules can be found in an important area of law that impinges on every corporation. Second is the opportunity to make the law accessible and easily understood. Third is the fact that corporate governance will become even more recognised. Fourth is the opportunity to eliminate obscurity, inefficiencies, and lack of clarity, since a more uniform spirit would reflect the corporate governance rules. Fifth is the opportunity to erase unnecessary or overlapping corporate governance rules therefore eliminating the overly bureaucratic legal framework. Sixth is the fact that by reviewing and eliminating excess obligations, corporations would be able to increase their levels of compliance with those rules from moderate to satisfactory.

The Role of the Athens Stock Exchange

Stock exchanges can be an effective means to enforce corporate governance standards and promote governance efficiency, even where legal and judicial institutions are less efficient. More particularly, the efficacy of stock exchanges as enforcers is demonstrated, for instance, by the adoption of listing rules, which require companies to comply with certain governance requirements or explain publicly why they have not done so.[640] In many respects this 'comply or explain' approach has proved to be an effective mechanism for enforcing corporate governance because companies are reluctant to disclose their failure to adhere to such standards.

In Greece, it can be argued that the Athens Stock Exchange (ASE) is a high performing stock exchange. Further, in terms of corporate governance, a number of initiatives, such as the sponsoring of corporate governance assessment exercises, and the establishment of qualitative criteria on corporate governance, manifest the ASE's interest in corporate governance. However, there is still room for more initiatives to be taken and greater activism to be shown in further boosting its role in promoting good governance.

First, the ASE should be aware of its importance as an agency in promoting a thorough understanding of corporate governance matters and how to achieve best practice. For instance, through the organisation of workshops and seminars, alongside the sponsoring of events and publications on corporations, the ASE can establish to corporations and market participants the benefits of improved corporate governance.

[640] *See, e.g.*, Weil, Gotshal & Manges LLP, Comparative Study of Corporate Governance Codes Relevant to the European Union and Its Member States – Final Report & Annexes (January 2002), 16, 19.

Second, the ASE can contribute to a better corporate governance system by issuing listing requirements including at its core corporate governance components. Reforming exchange listing rules is often easier than reforming general securities or company statutes.[641] In this context, the threat of delisting or of the possibility of a rejection to enter their shares into the stock exchange provides exchanges with a unique ability to compel compliance with the rules they set. In this sense, stock exchanges enjoy special self-enforcement abilities.[642]

Third, by effectively implementing the existing rules that set the minimum standard of transparency, focusing mainly in reporting requirements, in that such rules are backed up with fines and/or suspensions from trading. It is important that the ASE devotes sufficient resources to ensure that companies adhere to specific rules and make clear that non compliance would bear penalties.

Fourth, the role of the ASE is important in facilitating listed companies to comply with current transparency requirements. This can be through the development of automated, web based systems to make disclosure of corporations easier. For instance, it is recommended that such a web based filling system be developed in an attempt to accelerate filling and replace paperwork (e.g. paper form or fax submissions).

Fifth, it is important that the ASE's interest in good corporate governance should also be focused on education and training. It is important that the ASE initiates, or sponsors training solutions to fulfil listed companies'

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[641] *See, e.g.*, Millstein, I. R., 'Non Traditional Modes of Enforcement' in I. M. Millstein, S. G. N. Bajpai, E. Berglöf and S. Claessens (eds.), *Enforcement and Corporate Governance: Three Views* (Global Corporate Governance Forum, 2005) Focus 3, 1-15, 12.
[642] *Id.*

training requirements. For instance, by organising open courses or executive training programs aiming to assist listed companies in their continuing professional development and specialisation in corporate governance.

Reforming the Greek System of Courts

As in all countries, likewise in Greece the rule of law is essential for governance efficiency. As analyzed above, although good laws are important, even more essential is their effective implementation. However, as often seems to be the case in Greece, the existing mechanisms and rules of behaviour are reasonable and good, but the process of implementation is opaque and the likelihood of effective implementation is low. Part of the blame for Greece's ineffective implementation of rules can be accredited to the lack of an honest, independent, and well-functioning judicial system, alongside the moderate performance of the Greek courts.

The process of improving governance efficiency raises as a top priority the need for reforms of the judicial system, with particular emphasis on mitigating the deficiencies of the Greek system of courts. Addressing such deficiencies demand well-designed measures and appropriate actions to be taken within the framework of a comprehensive strategy for the reform of the judicial system. Further, the success of such strategy demands political will and strong commitment of policy makers, the business world, and the society at large, to change deeply rooted decision making structures and societal balances favourable to corruption and injustice.

At the core of the recommended reform stand four key targets. First is to ensure the independence of the Greek court system aiming further to increase impartial court decisions to be reached. Second is to increase its efficiency in an attempt to mitigate, for instance, the problems of slow court procedures, or the prolonged execution of decisions. Third is to increase judicial accountability in that instances of unprofessional and corrupted behaviour of judges is eliminated. Fourth is to ensure that cases relating to violation of shareholders' rights are brought before the courts, contributing in turn to further strengthening management's accountability and opening the way for improved governance efficiency.

To start with ensuring the independence and enhancing the efficiency of the court system, recommendations are mainly directed to redefining the position and the competencies of courts in that efficient, stable, independent, and accountable courts are set up. Essentially, recommendations encompass those actions that need to be taken in further strengthening the independence of courts from political influence and eliminating corruption of judges. These can be achieved, *inter alia*, by means of reviewing the status of judges (and other public prosecutors), their selection procedures, their salary schemes, and their training and expertise.

More particularly, with regard to the status and the position of the judges, in an attempt to reduce instances of political pressure, conflict of interest, and corrupt judges behaviour, it is important that a somehow stricter implementation of the current prohibition on judges holding other public functions or professions or be members of political parties be achieved. The success of this prohibition heavily depends on two conditions. First, the extent to which incompliant behaviours with such prohibition are couched with strict and high fines. Second, the efficiency and the independence of investigation proceedings in that corrupted investigators tend to conceal such behaviours against a personal gain. Therefore, the above conditions should be addressed if the court system is to assume its efficiency and credibility.

Consideration should be also given to the creation of specialised units responsible for handling the investigation and enforcement of corporate and securities laws. The importance of such specialised benches or courts is twofold. First is the reduction of backlogs of cases, permitting speedier resolution. Second is the development of specialised knowledge, in that judges or prosecutors sitting in these units shall demonstrate solid understanding of the relevant laws, alongside knowledge of market practices. In addition to the creation of such specialised benches to deal with corporate governance matters, it is recommended that a specialised career path is created within such units. This will further help prosecutors or judges to pursue or advance their specialisation in corporate, securities, and financial cases.

In terms of judicial accountability, in order to enhance the performance of courts, it must be set clear that judges have a right and obligation to continuously improve their professional knowledge in the course of performing the function of a judge. It is recommended that a scheme of continuing legal education be designed for judges and prosecutors that would include issues on Greek corporate governance.

From an information technology perspective, so as to simplify and accelerate court procedures and manage court cases more efficiently, a comprehensive justice information system project needs to be initiated. Such project that can also include sub-projects related to all judicial segments as part of the general information technology project facilitates the courts' computerization and the development of software applications in the courts. In addition, for further boosting the efficiency of the judicial system it is recommended that a complete electronic network is developed in order to link all information systems of each institution (e.g., the courts, the Ministry of Justice, Public Prosecutor, etc.). This network will be designed to ensure, inter alia, that an electronic database is developed showing more precise statistics on the inflow of new cases, cases pending in each body, department, and employee separately.

Enhanced Shareholders' Rights and Activism

It is important that initiatives be taken to enforce shareholders' rights and to ensure remedies for violations of shareholders' rights. The success of such initiatives depends on a reasonable level of shareholder activism. In Greece, there are few signs of such activism. Most importantly, the problem with the level of protection of shareholders' rights seems to rest on the fact that the Greek law does not provide a reasonably broad range of administrative, criminal, and private litigation sanctions against violations by corporations or directors. In view of such lack of effective remedies for violations of shareholders' rights, it is recommended that laws should be amended to enable shareholders to pursue claims.

First and foremost, consideration shall be given to the adoption of class action lawsuits to permit shareholders to pursue violation of rules relating to corporate governance. The permit to class action lawsuits will foster management's accountability and make shareholder litigation more frequent. Such class action procedure or another efficient way to enable the claims of shareholders to be brought before the court, is an essential component of well functioning and efficient corporate governance system.

Second, in further strengthening the protection of shareholders' rights the option of arbitration appears as an effective mechanism to resolve disputes between shareholders and the company. More specifically, the Greek legal framework (e.g. the Greek Corporations Law[643]) should be amended so as to allow corporations to provide in their articles of association that disputed between shareholders and the company can be also redressed by arbitration. The benefits of arbitration (such as the expertise of arbitrators chosen, the low cost, and the speed of disputes' resolution) underline the significance of considering such an approach in further safeguarding shareholders' rights.

Third, another important suggestion that can motivate shareholders to take action to enforce their rights relies on the reimbursement of litigation costs in case that shareholders prevail in a suit. Full reimbursement of litigation costs is a significant incentive for shareholders to initiate litigation. On the contrary, even in cases that there has been a clear violation of laws, shareholders are discouraged from starting litigation procedures in view of the increased cost.

All the above recommendations are important mechanisms to increase shareholders' activism. Increased activism, in turn, ensures that corporate governance deficiencies and breaches of corporate governance regulations are not left unnoticed and most importantly unpunished. Therefore, provided that an efficient and transparent system of courts is established, as aforementioned, the above recommendations work towards enhancing governance efficiency.

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643 *See, e.g.,* Hellenic Law 2190/1920 *on Public Limited Liability Companies* (sociétés anonymes), Official Government Gazette A37, as codified.

Other Recommendations

The Role of Business Associations and Unions

Complementary to the importance of corporations' own realization for the positive efficiencies of good corporate governance, the active role of business associations and unions is important in further raising the corporations' awareness and for providing incentives for greater compliance.

In this context, the role of the Federation of Business and Industries (FBI), the former Federation of Greek Industries,[644] is recognized and should be further encouraged. More particularly, the renaming of the Federation reflects and confirms its readiness to face the new demands of the economy and society, at large. In a historic setup, the Federation and the Union of listed companies in the Athens Stock Exchange (ASE) issued, in August 2001, the voluntary 'Principles of Corporate Governance', as a means to demonstrate their preference in self-regulation.[645] One of the main recommendations included the establishment of board level committees consisting of a majority of non-executive directors and the implementation of internal control by a specific department or individual. Such initiative revealed the strong interest of the Federation in good governance, yet it was not followed up by other initiatives in the same field.

[644] It is important to note that this is the third time that the Federation of Business and Industries has been re-baptised. From the original Federation of Greek Industries and Crafts in 1907, in 1946 it became the Federation of Greek Industrialists, and then in 1979 the Federation of Greek Industries. These name changes mirror strategic developments in the nature of Greek business, the economy and society, and point to the Federation's desire to move along with these developments and play a leading role within them. The new Statute aims to allow more flexibility to the Federation. *See, e.g.,* Daskalopoulos, D., (speech by the President of the Federation of Greek Industries – SEV- at the afternoon session of the Annual General Assembly, Athens, Greece, 24 May 2007) (in Greek).

[645] *See, e.g.,* Federation of Greek Industries (FGI), 'Principles of Corporate Governance' (in Greek) (2001) Athens, Greece.

Furthermore, the Union of listed companies in the ASE is an important forum, which promotes the interests of listed companies and develops best practices in several areas that are crucial to their operation. In a similar vein, the Union of Societe Anonymes and Limited Liability Companies through the publication of surveys and reports on corporate governance can significantly contribute to the objective of fostering and establishing an efficient governance system. In this setup, it is encouraged that both unions should assume greater roles, be more active by taking up new initiatives so as to further raise companies' awareness of good corporate governance. It is, however, unfortunate that since the establishment of both unions, no initiatives have been recorded to the direction of promoting good governance. Therefore, it is necessary that both unions divert their mission by switching their focus towards good corporate governance, so as to play a leading role in that regard and manifest that well run corporations are the assurance of better functioning markets.

Establishment of a Corporate Governance Association of Greece

In principle, the recommended establishment of a Greek Corporate Governance Association may play a significant role in the development of good corporate governance in Greece. The key aim of such an association will be to become the pioneer organisation in Greece for bringing corporate governance from textbooks and laws to boardrooms agendas.

In practice, the promotion of good governance within the context of the operation of such association could be achieved through the following means. First, the organisation of training programs that would take place across the country aiming to develop the corporate governance culture and assisting corporations in implementing governance requirements.

Second, the conduct of research on important corporate governance topics, such as for instance the effectiveness of corporate directors. Such research and its follow ups would facilitate depicting governance weaknesses and trends to eliminate such deficiencies.

Third, such an association could also issue codes of best practice in further raising corporations' awareness on good governance.

Fourth, through the organisation of panels and seminars cross pollination of ideas and exchange of information on important corporate governance issues would be accomplished. During such events, executives, academics and other key players of the business world would get together to discuss and be informed on governance trends and how to achieve best practice.

Fifth, alongside the publication of books and articles that could become the reference point for those interested on corporate governance, such an association could also release newsletters. Such newsletters, the frequency of which could be monthly, would help corporations become aware of corporate governance developments both in Greece and abroad. In addition through such newsletters corporations would be kept informed of main events and training programs.

Establishment of Shareholders' Association

Given the absence of strong shareholders' activism it is recommended that interest groups be set up to initiate, *inter alia*, lawsuits, class actions, and other important litigation tools in strengthening enforcement of shareholders' rights. More particularly, consideration should be given to the establishment of shareholders' associations aiming to protect and promote shareholders' interests. After the example of a number of European countries, such as for instance Denmark, Finland, United Kingdom, Norway, Germany, etc., Greece shall move forward on establishing its national shareholders' association.

The purposes of such associations can be numerous. First is to educate their members on various financial and securities markets' issues, including on corporate governance matters, through the organisation of workshops and courses. Second is to support and represent private investors' rights by taking legal action against the company or the officers to protect the interests of its members. Third is to serve as a channel of communication for corporate information by making various publications (such as for instance magazines, email newsletters, guides, etc.) and the provision of regular updating of prices and financial data on companies listed on stock exchanges. Fourth is to facilitate shareholders to monitor themselves the developments in corporations' financial data by the development of software for analysing stocks.

Alongside the protection of shareholders' rights, such associations should work towards improving the standards of corporate governance and ensuring a fair market for private investors.[646] Shareholders' associations encourage shareholder activism and are reckoned significant for strengthening management accountability and fostering governance efficiency.

[646] For more information on the purpose and the services provided by the United Kingdom Shareholders Association visit http://www.uksa.org.uk

Establishment of an Institute of Directors

Finally, the establishment of an institute of directors, either as a private initiative or by the Greek government, is recommended mainly for two reasons. First is to foster the work and help the professional development of directors (including both independent and executive) by providing training courses, practical seminars, research and technical support to company directors. Second is to set standards and principles that all directors shall respect at a minimum (such as for instance, to ensure that appropriate internal structures are in place so that shareholders to have access to corporate information). Third is to provide a professional network through which directors can receive advice on difficult topics. Cross pollination of ideas and sharing of experience also can be encouraged. Fourth is to lead effective lobbying in influencing government's policies and speak out clearly whenever change is needed.

CONCLUSION

The corporate governance discussion has only lately started in the Greek landscape and there are relatively few scholarly accounts of corporate governance in Greece. This thesis is one of only a small number of studies, which undertakes an in-depth and critical examination of the dynamics of the Greek corporate governance framework.

The initial motivation to conduct a research on corporate governance was driven by the heated debate on the collapse of Enron. At that time, being a master's student and not that familiar with corporate governance issues, I only had one question in my mind. why is there so big a discussion about corporate governance? To find answers, I started researching the concept of corporate governance and aiming to understand its significance. Some of this research is included in chapter one. I decided to start this thesis (chapter one) with the question that put me on the first line for embarking on this PhD thesis.

In the course of the research, three main objectives were pursued. Firstly, to understand the nature and the necessary components of the Greek corporate governance system. Secondly, to discuss the discrepancy between the objectives of the corporate governance standards, compliance, and actual governance efficiency. Thirdly, to suggest alternative means and measures that need be taken to ensure that the objectives of the corporate governance are fulfilled and governance efficiency is strengthened.

Corporate governance is a dynamic and interdisciplinary concept that describes those mechanisms aiming to align the interests of the principal and the agent in order to enhance the business development and ensure the protection of shareholders' rights. The original principal-agent theory provided the key theoretical foundation upon which it was later understood that the varying agency concerns needed to be explained in a more contextualised approach. There was a need to adopt an approach that explains the many different corporate governance structures around the globe, to focus our analysis later on the characteristics of the Greek corporate governance system.

To understand the shape of the Greek corporate governance system, it was important to thoroughly study the Greek capital markets law and securities legislation, the OECD corporate governance principles, and the EU capital market law. Those legal sources have provided the legal background for defining numerous corporate governance standards in the Greek domain. Their impact has been so pervasive that to discuss Greek corporate governance framework otherwise than in the light of those legal sources would be tantamount to disregarding an essential ingredient in the formation of its corporate governance universe.

To determine that there is a discrepancy between the objectives of the corporate governance standards, compliance, and actual governance efficiency, it was necessary to rely on the statistics of two corporate governance surveys conducted by Grant Thornton International. Those surveys measured the level of compliance of Greek listed companies with corporate governance requirements and international best practices. Significantly, the contribution of the present thesis is that it explained the numbers upon country specific attributes. For instance, although the statistic that in about 6 out of 10 companies the CEO and the Chairman of the Board are the same person is important information, it is more valuable for policy makers to know that this statistic is due to the family origin of most Greek corporations.

In this vein, the explanation of the above statistics upon situational variables is a key innovation of the thesis, which further contributes to the following. First, particularly in the Greek literature this is the first full length study that not only outlines the characteristics of the Greek corporate governance system, but also goes further in discussing the effects of such attributes in terms of compliance behaviour and governance efficiency. Second, by identifying what country specific factors are responsible for certain compliance behaviours, it helps policy makers, and the corporations themselves, to better design realistic and appropriate measures to mitigate problematic aspects of compliance, in further enhancing governance efficiency.

The thesis concludes with a number of proposals, which are to be part of a general corporate governance reform strategy aiming to improve governance efficiency. The conclusions of this study are relevant for students, academics, policy makers, Greek corporations, and Greek regulators.

Legal material with regard to the Greek laws, Presidential Decrees and other explanatory notes from the Parliamentary meetings necessary to sketch the Greek corporate governance framework were drawn from a large number of visits to the Greek Parliament and the National Printing Agency of Greece. Given the fact that those resources are only available at the premises of these national bodies, following special visiting arrangements, the collection of the material on its own right makes the present study a difficult and challenging one and useful tool for further future research.

Data used in order to assess the level of compliance of Greek corporations with the corporate governance rules were drawn from the Corporate Governance Surveys conducted by the Grant Thornton International in Greece and my reflections as an observer-participant in both Grant Thornton conferences for the presentation of the main findings of the surveys. Those conferences were held in Athens, Greece, on 24 November 2005 and 18 April 2006, respectively.

Essentially, the present study is a synthesis of theoretical and empirical insight, bringing theory and empirical evidence together in an effort to support its claims. At a theoretical level, the main contribution of the present thesis rests on the fact that it provides the central theoretical resource, which is essential for explaining other empirical studies that have been conducted for the specific context of the Greek corporate governance. The study aims to provide the main starting point that will facilitate further research on the Greek corporate governance and advance the awareness of Greek corporations on corporate governance issues.

More particularly, given the interdisciplinary and dynamic nature of the concept of corporate governance, it interacts and its ends meet with a number of interesting research topics. Three areas have been identified where further research will be significant to advancing international, and likewise Greek, corporate governance literature. First, research on the corporate governance issues with respect to non-listed firms, financial and credit institutions, financial conglomerates, and not for profit organisations that play important role in the Greek capital market. Second, the recent hedge fund scandal that had shaken the Greek capital market, when pension funds were invested under dubious terms and conditions, gave rise to concerns on the proper governance structures of pension funds' organisations and of those government bodies that monitored their investment policies and activities. Third, in the post 9/11 era good governance structures of financial and credit institutions are reckoned important for promoting a strong framework so that the use of the financial system for the purposes of money laundering and/or financing of terrorism will be eliminated. Therefore, another important area for future research has been identified the examination of the correlation between good corporate governance and compliance with money laundering restrictions.

The corporate governance literature is quite extensive covering the varying aspects of the concept, which can be approached from different theoretical, social, legal, disciplinary, and economic angle. This thesis is hoped to become a comprehensive reference point for Greek corporate governance, a valuable academic tool to teach students and professionals, and stimulation for meaningful governance reforms.

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